ECONOMIC ASPECTS

OF

GOVERNMENT INCOMES POLICIES

by

P.R.G.B. Gardiner

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INTRODUCTION.

Since World War II a special interest has been generated in incomes policies in industrial countries as a result of persistent inflation. During the War nations were obliged to give close and continual attention to the control of wages and prices in view of the acute scarcity of manpower and other resources and the urgent need to secure an extremely rapid mobilisation of all available resources for the over-riding purpose of winning the war. It rarely, if ever, occurred to economists at the time, that inflation would still remain a serious problem after countries had adjusted their economies to peace-time conditions and after the immediate "pent-up" demand existing at the end of hostilities had been satisfied.

Even before the end of the War, economists were thinking of ways in which the anticipated depression could be reduced. Most, if not all, of them seemed to consider that full employment, as it has now come to be accepted in industrialized countries, was unlikely. Lord Beveridge himself was not optimistic that unemployment could be brought below about 3 per cent of the labour force.(1)

As the war era receded and the world moved into the second half of the century, inflation remained a major problem in most Western countries and the wide-spread economic stagnation which economists had feared, failed to re-appear. Instead rising prices and wages, accompanied by a high level of employment relative to pre-war conditions persisted, despite warnings by economists that the high level of economic activity would not last.

Accordingly/........

(1) LORD BEVERIDGE: "Full employment in a Free Society". (1944)

Accordingly it was to be expected that governments, anxious to avoid the dangers stemming from continually rising prices - particularly in view of balance payments crises - would look for some method for controlling incomes so that inflation could be stopped or at least contained within an acceptable, although often not clearly specified, limit. Incomes policies have thus been conceived and applied under various economic and social conditions in an attempt to help preserve economic stability. This stability was intended to include fostering economic growth, ensuring an equitable or "socially just" distribution of income and a healthy balance of payments.

By 1970, however, a considerable measure of disenchantment towards incomes policies is discernable among many employers, trade unionists and politicians in western nations in view of the lack of success of these policies, especially in the longer term, to contain inflation with any great degree of success.(2) The purpose of this thesis is to attempt to survey and analyse incomes policies in Western countries which have instituted them and to try to explain the economic problems that confront economies which apply them with the prime object of checking inflation. It is, moreover, important to consider whether the disappointing results flowed from policies which were basically inappropriate for the economies for which they were designed, or whether they were due to a lack of determination by the authorities to carry them out, in view of public hostility towards this kind of government intervention.

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(2) The Editor in the Preface to the article by F.W. PAISH entitled "Rise and Fall of Incomes Policy", remarks that "the economic discussion of 'incomes policy' has now changed from its merits, which are seen to be few, and its demerits, which seem more obvious, to the reasons for its failure (in Britian) and the extent to which statistics record its unhappy history".
HOBART PAPER No. 47, June, 1969.

Incomes policies can, of course, be taken to include many types of direct and indirect government controls and methods of distributing the national product. It is intended, however, to limit the survey to a consideration of their specific objective of controlling inflation, as distinct from their objectives, such as reducing the disparity in incomes within a community or the social welfare aspects of pensions and unemployment. We shall, therefore, be dealing in the main with incomes policies in the narrower sense "of the relationship between changes in ......real income and changes in the aggregate of money incomes taking place in the economy at the same time"[(3)].

The isolation of one specific goal of an incomes policy is a difficult operation. Policies, even if developed primarily to counter inflation, do include other issues as well and it is impossible to ignore them as they inevitably intrude into the formulation and application of any particular policy. Moreover, they may serve to modify, retard or assist the attempt to secure a greater degree of control over the causes of inflation.

R.C. Tress is surely correct in pointing out that this connection between the narrower and the wider meanings must not be forgotten. For example, he reminds us that the National Incomes Commision established in 1962 was instructed to have regard to ....."the desirability of keeping the rate of increase of the aggregate of monetary incomes within the long-term rate of increase of national production"[(4)]. Tress observes that "clearly this undertaking is a pursuit distinct from that/.......

(3) R.C. TRESS "Incomes Policy in the United Kingdom". A paper from "The Distribution of National Income" edited by J. MARCHAL and B. DUCROS.

(4) Cmnd. 1994 H.M.S.O. 1963, pp ii - iii

that of trying to formulate a policy for dividing up the national product. "Yet it is important", he continues "to recognise the connections between the two, as an appreciation of some of the difficulties in formulating an incomes policy in the current (narrower) ..... sense - and of some of the obstacles to its application - stems from them".[5] It will be seen when we study the British and Dutch incomes policies how the wider meaning of the term may influence the application of the policy and may make its successful implementation much more difficult.

The political process is intended to give the electorate in democratic societies the opportunity, at regular intervals, for expressing its approval of the economic and social policies of the government. The attitudes and conditions within a society and the decisions of the government of the day will therefore, together determine to what extent an incomes policy as distinct from other policies will be the instrument used to promote the economic and social development of the country. Indeed, it will be emphasised later that without the co-operation of the community as a whole, an incomes policy providing for direct government intervention in the fixing of prices and wages is almost unworkable even for a relatively short period. Some of the objectives of the community will, no doubt, conflict and will need to be reconciled or "traded off" against one another. A more equal distribution of income between individuals may, for example, entail a relatively slower rate of growth.

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(5) R.C. TRESS op cit. p. 682.

Incomes policies, irrespective of the relative importance attached to the various ends they pursue, have always been applied in conjunction with other policy instruments such as the conventional fiscal and monetary measures with which we are more familiar. Even if an incomes policy were to have only the single specific job of controlling inflation, it would still require to be applied in association with other instruments such as taxation and credit controls. We must remember that the relationships between those variables significant in causing inflation may shift over time. Indeed the more sophisticated and complex econometric studies[6] now being attempted may well indicate that the "navigation instruments" government departments have been using are not only inaccurate but are fundamentally wrong.

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(6) The article by DR. J. BRAY in "The Economist", 30th May 1970 is important for its challenge to what Dr. Bray refers to as the "conventional wisdom". He suggests that the model by GODLEY and SHEPHERD on which the British Treasury appears to place considerable reliance for its economic forecasts may be basically unsound.

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Chapter 1 /....

CHAPTER I.

It was indicated in the introduction that an incomes policy could be variously defined according to/what sense the term was to be used. In the present context a useful definition may, perhaps, be "the effort to acquire a degree of direct collective control over the level and structure of the remuneration of labour and capital and over the distribution of the national income to households and enterprises".(1) The authors of this definition observe that the use of the words "direct ... control" distinguishes incomes policies from other instruments of economic management such as monetary and budgetary policies, prevention of competition, foreign trade controls, growth policies and many other instruments which affect the level of national income and its distribution. They also add that the term "collective" rather than "government" control has been adopted because in Western countries even where the State has certain compulsory power, it must "influence primary incomes mainly by guidance and persuasion of management, workers and their representative organisations .... it is the policies adopted by these collective organisations which must be the instruments of incomes policy".

Although the definition is wide it succeeds in eliminating many other policies which would have to be included if the concept were defined in its broadest sense. Nevertheless it must be conceded that it does leave a measure of ambiguity as to the precise nature of the government's role

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(1) This definition is taken from "INCOMES IN POST-WAR EUROPE. A STUDY IN POLICIES, GROWTH AND DISTRIBUTION. U.N.E.C.E (1967) Ch. 1, p.2.

in any system, namely, whether the State both has, and, in addition, uses specific legislative powers to prevent increases in particular incomes from rising above a certain defined level. The Report by the Organisation for European Economic Co-operation, "The Problem of Rising Prices"(2), when referring to wage policies is unequivocal in its assertion that "vague exhortation" by the government, informal understanding unchecked by special powers, arbitration machinery where there is no instruction "as to the average wage increase appropriate to the economy", government intervention in cases of disputes designed to encourage or facilitate settlement and centralised wage negotiation by and of itself, are not strictly wage policies. They insist that the Government must have a "reasonably precise view .... of the average increase in wages that is appropriate to the economic situation and consistent with stability of the price level". Although these conditions would appear to rule out any type of voluntary incomes policy some attention will be given to voluntary policies in order to establish why legislative powers are normally a prerequisite for effective incomes policies.

The means which a government has to make a particular policy effective is, indeed, an essential part of any policy designed to control the rate of inflation. It is necessary to bear in mind that no matter how precise or detailed the policy may be, the methods by which it is to be applied will be of fundamental importance for its success.

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(2) "THE PROBLEM OF RISING PRICES". O.E.E.C. (1961)p.58

A piously enunciated objective, no matter how clearly spelled out, is not worth consideration as a policy if the sectors of the community to whom it is addressed do not intend to observe it and know the government has no power to make them do so. Indeed, Jossleyn Hennessy has argued (3) forcefully that an incomes policy to control inflation can only be attempted if the government sets up an authority to decide periodically

"(a) by what total sum incomes can be allowed to rise without causing inflation:

(b) how it is to be allocated among thousands of categories of skills in the nation's working population; .....

(c) how employees can be compelled to accept as 'fair' the shares allocated to them".

It would seem clear, although this does admittedly anticipate the later discussion in Chapter III on guidelines and guideposts, that there should be some element of compulsion within the framework of the policy for it to be properly regarded as an incomes policy, although statutory powers may be held in reserve, and rarely, if ever, employed.

It is, in addition, necessary to distinguish between a wage policy - including salaries - and an incomes policy. Strictly, a wage policy is concerned only with certain types of incomes, namely, that share of the national product going either to labour as a whole or to certain categories of labour such as unionised labour, the lowest paid sections of labour or labour in specific industries or carrying out particular types of work. Properly, an incomes policy is a wider concept including non-wage incomes such as rents, interest and profits. The economic aspects of controlling non-wage incomes, however, involve problems/...

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(3) "INCOMES POLICY IN EUROPE". Part II of 'Policy for Incomes" Hobart paper No. 29. Institute of Economic Affairs.

problems not associated with wages such as the rewards for risk-taking by entrepreneurs.

Having attempted to describe what the concepts of "incomes policy" and "wage policy" include and the difficulty of providing a really satisfactory definition, it is now necessary to approach a definition of inflation. Definitions of inflation are, of course, legion. Some economists define inflation as the increase in money incomes "out-stripping the sustainable growth of output".(4) This definition is, perhaps, insufficient as it does not clearly establish that all money incomes need not necessarily be spent or, indeed, even be received by the factors of production earning them. It may be preferable to add the word "disposable" to indicate that the "gross" money income may not be available to satisfy demand, in so far as the State itself siphons off in taxes, a proportion of all incomes above a certain minimum level. On the other hand, the distinction may be misleading as the government can and often does, immediately pump back into the economy all the income taken in taxes, thereby merely re-distributing income from one group to another either in the form of investment and government spending or simply through transfer payments. Nevertheless until it re-appears again as disposable income it does not increase or lead to inflation except in so far as people anticipate its return and spend in anticipation. Furthermore, not all disposable income is spent by those earning it, and the portion saved may not be invested if "investment" is used in the sense that it involves further real expenditure. It may be more accurate to regard inflation as the excess of intended or planned spending over the "sustainable growth of output". This would

emphasise/...

(4) F.W. PAISH. "Policy for Incomes?" Hobart Paper: No. 29 p. 13 (1964)

emphasise that the intention of the recipients of income is of particular relevance - namely the relationship between total planned spending and total planned output. The more familiar and somewhat more popular description of inflation as the persistent general rise in prices may tend to obscure the aspect of excess monetary demand that lies behind it.

Inflation may be initiated and perpetuated in different ways. It is of crucial importance for the authorities to appreciate the nature of the relationship as the instruments for dealing with inflation will depend upon what are regarded as the principal reasons causing the excess monetary demand leading to the rise in prices. Even the above definition of inflation leaves something to be desired because it tends to disregard the inflation usually referred to as "cost-push" rather than "demand-pull", and, moreover, it does not distinguish between money incomes and the money supply, all of which will require examination.

The 'raison d'etre' of an incomes policy in the narrower sense in which we have defined it, is to ensure the full-employment of the resources of a country without at the same time enduring an unacceptably high rate of inflation. It is this conflict between a high rate of growth being sought with a high level of employment but at the cost of a high rate of inflation that has been at the heart of many of the so-called "stop-go" policies since World War II. The supporters of incomes policies have generally argued, often cogently, that full employment and a high rate of economic growth are possible without inflation only if the government is able and has the will to prevent the rate of increase in incomes from outstripping output, so that the excess demand for labour will not result in employers bidding up wages and therefore raising prices in a continuing wage-price spiral. Without such government intervention the exponents of this argument claim that the only effective alternative to inflation is to reduce demand by

monetary/........

monetary and fiscal means and to have part of the country's resources unutilised. They contend that in the real world a margin of spare capacity is necessary to avoid inflation but that an incomes policy can reduce this margin substantially. Similarly they argue that an incomes policy would prevent the monopoly power of both unions and employers in key industries from raising prices and wages and causing rising unemployment in other sectors of the economy, as well as underutilisation of labour resources in their own sector.

In the real world it is generally far from easy to determine in any given set of economic conditions to what extent the inflation is of one kind or the other. A rise in prices may at first sight appear to be purely a "cost-push" inflation sustained by the demands of unionised labour. This conclusion may be misleading as the demands may reflect the unions' claim for wage increases lagging behind a general rise in the price of commodities, this rise being the result of excess demand created by increased government spending, by an increased money supply or by a reduction in taxes.

Indeed as H.A. Turner and H. Zoeteweij have pointed out,(5) merely because wages appear to have risen before prices, does not necessarily indicate that the inflation is of the "cost-push" variety, as "it might also be the case that the wage increase was a delayed adjustment to a much earlier price increase". The difficulty of deciding whether inflation is caused by union power or by excess demand at an earlier stage, is undoubtedly ever-present. "The difficulty". Turner and Zoeteweij add, "is to distinguish between the two cases in practice, this is all the greater because they are liable to be combined in different proportions in different situations". F.W. Paish, however,

has/........

(5) "Prices, Wages and Incomes Policies in Industrialised Market Economics" H.A. TURNER AND H. ZOETEWEIJ. International Labour Office, Studies and Reports. New Series, No.70 p.78.

has contended that although inflation may be sustained and perpetuated by labour pressing for increased wages whether because of its monoply power or because there is excess demand for labour, a general rise in prices in unlikely to be initiated by "cost-push" inflation because employers will know that if they raise prices there will be a reduction in demand and if they were previously maximising profits, their profits will now decline. In these circumstances they will try to resist union demands but if they cannot do so, their output and sales will be lower and this in itself will lead to unemployment and so will tend to discourage inflationary trends. Paish argues that firms will only raise their prices and maintain their level of production if they are satisfied that the higher prices can be passed on to the consumer without a loss of sales. Firms must be confident that there will be an increase in aggregate incomes in the economy to justify the same level of production at higher prices. This would suggest that firms anticipate inflation otherwise they would behave in a different manner. Paish therefore claims that "cost inflation has become the way in which inflations are perpetuated rather than initiated".(6)

In the following chapter we shall be studying in some detail the empirical work on inflation which has been carried out in recent years in so far as it has a bearing on the possible advantages of incomes policies over other measures, for curbing inflation. It might, perhaps, be appropriate before doing so to point out the significance of the money supply in an inflationary situation. Economists have often stressed that for an inflation to be prolonged it is necessary for the supply of money to be increased. It is not sufficient merely for money incomes themselves

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(6) F.W. PAISH "Policy for Incomes?" op. cit. p. 15

to increase. However, if at an early stage in the inflationary spiral there are large idle cash balances suggesting low rates of interest, it may be a lengthy period before the constant supply of money is able to exert a significant influence on the rate of inflation. An increase in the velocity of circulation of money can enable prices to continue rising to a level unacceptable to the authorities long before rising rates of interest have succeeded in drawing out all idle balances. The whole question of the quantity of money and its relation to the rise in the price level is a complex one in a modern economy. In particular, many substitutes for money have been developed and these substitutes together with the activities of banks, credit organisations and other financial intermediaries play an important part in sustaining the excess demand for goods and services, despite a relatively constant volume of money. Where the quantity of cash can be controlled directly by the monetary authorities the volume of money and the volume of money substitutes can also be controlled as they are themselves dependant upon a cash base. Nevertheless, the manner in which the supply of money affects the expenditure patterns in the economy of a modern state is intricate and often far from clear. It is worth noting, however, that H.A. Turner and H. Zoeteweij have defined inflation not in terms of an increase in money incomes, but as "an increase in the supply of money in relation to that of commodities"(7). The relevance of the money supply to the British problems of inflation will be considered later.

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(7) Op cit. p. 28

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CHAPTER II.

We observed in the previous chapter that it was usually difficult to decide firstly what was the relative strength and importance of all the factors causing an inflation and secondly whether there was enough evidence to justify the conclusion that a reduction in the level of aggregate demand would only be sufficient to reduce the rate of inflation if unacceptable levels of unemployment were to occur. We also implied that the stronger the element of "cost-push" inflation caused by the monoply power of unions and assisted by the price fixing behaviour of particular industries, the more appealing the institution of an incomes policy might become. These issues require further examination and will be discussed in more detail in this Chapter.

The "demand-pull" and "cost-push" models that economists have constructed vary from relatively simple illustrations representing extreme positions on either side to increasingly complex and abstract models which endeavour to trace the interaction and interdependance of both causes of inflation. The authors of "The Problem of Rising Prices"[(1)] have described, succinctly, the pure "demand-pull" version when they state that "pressure is put on productive resources as more and more goods are demanded, capacity is strained, a general labour shortage develops, and prices and wages are bid up by buyers and employers competing for scarce supplies". "Cost-push" inflation on the other hand is not caused directly by excess demand but it is result of the exercise of monoply power within industry either by unions alone or by unions assisted by firms which because of their importance in the economy and as a result of their methods of price determination enable unions

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(1) Op cit. p. 33. They define excess demand as "a volume of aggregate monetary demand which cannot be met at existing prices without exerting undue pressure on productive resources."

to secure higher wages than would prevail under more competitive conditions. If union leaders are relatively more concerned with pushing up wages that with ensuring a high level of employment either for their members or for other sectors of the labour force, a "cost-push" spiral of increased wages causing increased prices, which cause further wage claims can be sustained with increasing unemployment. The Government must eventually either impose a price and wage "freeze" or increase expenditure, reduce taxes, and loosen credit controls to enable other areas of the economy to counter the rising prices and increased level of unemployment which such monopolistic behaviour in key sectors may bring about. In addition, the government may be able to legislate with some success against certain types of monopolistic behaviour. This action may be rather unlikely in some countries both because of the manner in which highly capital-intensive industries have developed and also because of the attitude of organised labour.

F. Machlup (2) has pointed out that "opinion is divided on whether consumer prices in recent years have increased chiefly because industry has invested too much and government has spent too much (relative to the nation's thrift) or because big business has raised material prices and/or labour has raised wage rates too high (relative to the nation's increase in productivity)". Machlup considers the contention of economists such as F.W. Paish, who argue that "cost-push" inflation is, on the whole, unlikely to initiate a general rise in the price level unless inflation is already anticipated by employers who expect an increase in the money supply to follow. He concedes that whether the government/...

(2) F. MACHLUP: "Review of Economics and Statistics".
Vol. 42: (1962
pp 125 - 139.

government will permit an increase in the money supply to ensure that the output at higher prices is taken up, is an important question of fact. The spiral of increasing wages and prices by employers and unions depends to no small extent on the expectations they have as to what will happen to the money supply. Machlup rightly observes that each set of real world circumstances will have to be examined in the light of the expectations on both sides of industry as to what the monetary policy of the government will be. This is of material significance because if industry is persuaded that it will not be "bailed out" by the monetary authorities agreeing to an expansion of the money supply so that aggregate demand will not be reduced, both employers and unions will be much less confident about raising wages and prices. The relevance of the monetary policy of the government is stressed by Paish (3) when he reminds us that "each rise in money incomes will require the holding of more money to finance consumption, while each rise in prices of physical assets, and the titles to their ownership, will require additional money to be held for financing investment. If the total quantity of money is not rising", he concludes, "or rising only as fast as real output, money will have to be withdrawn from idle balances". As we saw in the previous chapter when touching on the money supply , this will cause an increase in the velocity of circulation and the rise in interest rates should eventually "choke off" excess demand. R.J. Ball (4) would appear to agree with this view and he remarks that a "self-perpetuating inflation requires a suitably expansionary monetary policy".

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(3) F.W. PAISH - op cit. pp. 14-15

(4) R.J. BALL. "Inflation and the Theory of Money".

In order to establish the soundness of any hypothesis it is necessary to look for empirical evidence of how individuals and groups react. We need to know how employers, unions, non-organised labour, and the owners of capital will behave in particular economic circumstances. We also need to know how the government itself will react and whether its behaviour will be correctly anticipated. In cases of monopoly "do labour unions and monopolistic firms largely disregard the state of the market in settling prices and wages" asks C.L. Schultz.(5) "Are prices marked up as costs rise with little regard for demand conditions? Does a rise in the cost of living lead to an equivalent wage increase in periods of unemployment?" Furthermore are unions motivated to demand higher wages in firms making above average profits? Does increased productivity in an industry result only in a higher rate of profit or does it reflect itself in higher wages and lower prices? Are highly capital intensive firms more susceptible to demands for wage increases than other firms? These issues are extremely complicated and Schultz suggests that there are few people who would take an extreme position on these questions. He thinks, rather, that there is a whole spectrum of opinion. If prices and wages over a substantial portion of the economy in industrialised countries are, indeed, administered in the sense that the commonly accepted market forces of supply and demand are at least partially ignored in the short-run and even in the longer-run where the latter may cover a period of five years or more, then the argument that "demand-pull" must be the initial cause of inflation would seem to lose a good deal of its force.

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(5) C.L. SCHULTZ "Recent Inflation in the United States", 1959.

This, of course, is an issue for empirical investigation and the results so far obtained are often conflicting.

Some economists such as Machlup distinguish between different types of "demand-pull" and "cost-push" inflation which does, no doubt, assist in illustrating that the more "simpliste" explanations are inadequate to explain satisfactorily a persistent inflation in the real world. Machlup uses the terms "autonomous", "induced" and "supportive" demand inflation to describe three separate expansions of demand. Autonomous expansion would refer to those which are "not linked to previous or to expected cost increases" while induced expansions are the direct consequences of a cost increase and might occur where firms borrow from the banking sector in order to pay for an increase in wages. Similarly people who receive higher wages may "increase instalment purchases and induce an expansion of consumer credit". Supportive expansions of demand would include instances where the authorities permit an expansion of credit or the money supply in order to avoid unemployment. This latter expansion would be the type mentioned earlier and possibly anticipated by firms.

Just as Machlup distinguishes three forms of demand inflation so also does he isolate three types of cost inflation, namely, "aggressive", "defensive" and "responsive" cost inflation. The first type would occur where unions decide to claim higher real wages because profits are rising or where wages are seen to be rising elsewhere in the economy. Defensive cost inflation would include the reaction of unions to increases in the cost of living index. Responsive cost inflation would refer to increases gained by labour which they would have achieved even without monopoly power, namely, increases flowing from the demand for labour which would have been offered by employers even in a competitive labour market.

This breakdown of inflation into its more detailed forms helps to single out the sort of relationships between groups or sectors in an economy that economists advising a government should be searching for when building up the structure of the incomes policy they hope to institute. It is the lack of clarity in determining causal relationships that makes attempts to control inflation in a complex economy so difficult. Even when these relationships are clearly identifiable there remains the problem not only of creating the instruments for guiding and directing them, but also the problem of timing any action so that the instruments used do not take effect on a changed economic condition for which they are no longer appropriate. Successive administrations in the United States, for example, have been increasingly criticised for using weapons which take so long to be effective, that they act on an economy that requires quite a different type of treatment.

So far in this Chapter we have dealt in a rather cursory manner with some of the complex issues lying behind inflations and therefore with some of the factors which may influence governments in making their decisions as to whether or not to institute a prices and incomes policy. It would be appropriate at this juncture to refer fairly briefly to some of the better known empirical investigations on inflation. As indicated already, the results are inconclusive. However, at the very least, they will serve to highlight the dilemma facing policy makers in government when contemplating direct intervention in the wage and price determination process in mixed industrialised states as in Western Europe and North America.

One of the earliest investigations and, perhaps, still one of the most celebrated, was that by Professor A.W. Phillips.[6] This particular empirical study was conducted in an attempt to identify a relationship in the United Kingdom between the rate of change of money wage rates and the level of unemployment. The results appeared to suggest that there was a non-linear relationship between these two variables. It seemed to indicate that over a period of approximately one hundred years the changes in the institutional environment did not significantly affect this relationship. Thus the conclusion derived from the statistical tests was that the increase in unionism, the evolution in the social climate and in social attitudes, the changing behaviour of industry regarding price determination, the increases in productivity or the changes in the rate of profit, were not sufficiently material over a long period to affect the relative closeness of the relationship between the level of unemployment and the rate of change of wage rates. If the institutional environment was not an important factor in the rate of change of wage rates, then this would seem to suggest that the government could determine fairly easily what level of unemployment was consistent with price stability. After taking into account the increase in productivity in industry the Government in the United Kingdom could calculate the increase in the rate of change of wage rates that would not cause inflation. Accordingly, by means of fiscal and monetary policies, price stability could be secured without direct intervention in the price and wage determination mechanisms.

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(6) A.W. PHILLIPS. "The relationship between unemployment and the rate of change of money wage rates in the United Kingdom, 1861 - 1957" Economica Vol. 25 (1958).

There was, of course, the implied condition that the level of unemployment required for maintaining price stability would need to be politically acceptable. Subject to this condition the rate of inflation would be determined by the level of unemployment that the country was prepared to tolerate. From this study he concluded that "ignoring years in which import prices rise rapidly enough to initiate a wage-price spiral, which seems to occur very rarely except as a result of war, and assuming an increase in productivity of 2 per cent per year, it seems from the relation fitted to the data that if aggregate demand were kept at a value which would maintain a stable level of product prices the associated level of unemployment would be a little under $2\frac{1}{2}$ per cent. If as is sometimes recommended, demand would be kept at a value which would maintain stable wage rates the associated level of unemployment would be about $5\frac{1}{2}$ per cent". Phillips has been criticised, however, on a number of grounds. Firstly, his critics argue that as his investigation referred to wage rates and not to actual earnings it is of little value because it is wage drift which is one of the principal causes of inflation. Wage drift would not be reflected in wage rates. Secondly, they contend that there is no necessarily clear-cut or logical connection between the two variables chosen. It has been suggested that they may change in the manner they do because they are both affected by some third variable, which remains unidentified. In addition it has been argued that the curves described by Phillips may in recent years have been changing. These contentions merit discussion because if they are correct they weaken or refute the conclusions drawn from the curves and will thereby influence government policy decisions based upon these conclusions.

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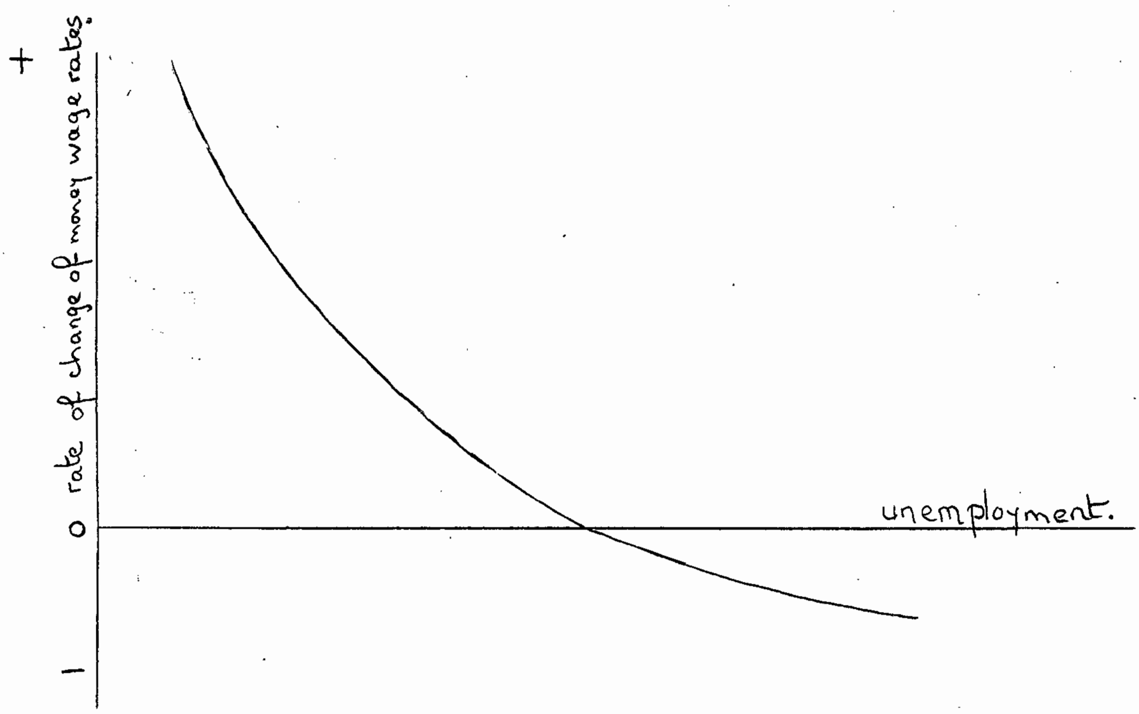
It will be recalled that the Phillips Curve is negatively sloped and non-linear. It intersects the horizontal axis at a level of unemployment greater than zero as depicted in the following diagram.



The dependant variable is, of course, the rate of change of wage rates. Some economists following on Phillips' work have preferred to substitute the rate of change of prices for the rate of change of wages. This is quite acceptable if there is some relatively simple relationship postulated between the rate of change in prices and wages. Lipsey, for example, uses this relationship.

The reason the curve intersects the horizontal axis at a positive level of unemployment is that there is normally some "frictional" and "structural" unemployment in the economy. Frictional unemployment may be defined as unemployment caused by the lack of perfect mobility of labour and implies a period of unemployment between terminating employment and commencing employment with another firm. Structural unemployment "is that unemployment which is thought to be associated

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with the structure of aggregate demand rather than with its level".[7] This structural unemployment may be expected to determine the precise location of the curve but not its shape and slope. If structural unemployment remains constant then frictional unemployment determines the shape and slope of the curve.[8]

Lipsey has argued that "given that people change jobs for whatever reason, and that a finite time is taken to change, zero excess demand must be accompanied by some positive amount of frictional unemployment. From this it follows", continues Lipsey, "that when the wage rate is stable, there will be some quantity of unemployment ...... the exact quantity being determined by the amount of movement and the time taken to move .... The larger is the excess demand the easier it will be to find jobs, and the less will be the time between jobs. Thus, unless there is a completely offsetting increase in numbers of persons moving between jobs an increase in excess demand will cause a reduction in 'u' (unemployment)".[9]

Corry and Laidler[10] have argued, however, that if the increase in the number of people moving to better jobs (as a result of increasing tightness in the labour market) completely offsets or more than offsets the decrease in the period of unemployment between jobs,

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(7) This definition is by BERNARD CORRY AND DAVID LAIDLER in their article "The Phillips Curve: A Theoretical Explanation". Economica, May, 1967, p. 193.

(8) This statement must be qualified in so far as PHILLIPS did include in his model the influence of changes in the consumer price index.

(9) R.G. LIPSEY: "The Relation between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1862-1957. A Further Analysis".

(10) Op cit. pp. 189-197. Economica Vol. XXVII (1960).

the Phillips Curve above the horizontal axis would either be vertical or positively sloped. They conclude that only if the curve is negatively sloped would it "lead to the all-important implications of the existence of a trade-off between the policy goals of high employment and price stability". Therefore the relationship between the rate of change of wage rates and unemployment resulting in a negative slope depends upon "very special assumptions which do not seem to be grounded upon any empirical analysis of this phenomenon". Nevertheless Corry and Laidler concede that the relationship appears to be statistically significant and accordingly requires explanation. They suggest that there is no reason why "the level of structural unemployment (assumed to be constant) should remain constant over time". Moreover, they add that there is no reason why "the level of frictional unemployment should depend solely on the excess demand for labour; it could well depend upon ..... the quality of information about job vacancies or their geographical distribution, which might vary over time". Furthermore, they suggest that "probably our ability to fit statistically negatively-sloped relationships to historical data shows no more than that there is no strong relationship between the level of unemployment and the rate of change of wages, and that a continuous negatively-sloped curve is hence a good approximation of the underlying economic process".

If the above contentions by Corry and Laidler are sound the policy decisions of government to reduce inflation by increasing the level of unemployment may be relatively unsuccessful. Thus fiscal and monetary policies may succeed in reducing aggregate demand and in increasing unemployment without significantly reducing the rate of

inflation/.....

inflation. Therefore different policies, such as an incomes policy, have sometimes been suggested as more appropriate economic measures.

Lipsey has replied to the criticism that the Phillips Curve refers to wage rates and not to earnings. He asserts that "although 'a priori' reasoning can suggest many reasons why rates and earnings might not move together, they do in fact stay, over any long period of time, remarkably close together, so that any theory that explains one will go a long way to explaining the other".(11)

Phelps(12), before developing a dynamic macro-economic model, criticised what he refers to as the "statistical approach" of Phillips and Lipsey. He contends that if the statistical optimum level of unemployment '$\tilde{u}$' depicted in the diagram below, results in inflation, "it is reasonable to suppose that the participants in the product and labour markets will learn to expect inflation (and the concomitant money wage trend) and that, as a consequence of their rational anticipatory behaviour the Phillips Curve will gradually shift upward (in a uniform displacement) by the full amount of the newly expected and previously actual rate of inflation". Further displacements may follow which may lead to either hyperinflation or to a steady-state inflation "where the actual rate of inflation is equal to the expected rate of inflation". The latter situation might occur when the authorities take action to increase the level of unemployment as well as accepting an increase in inflation.

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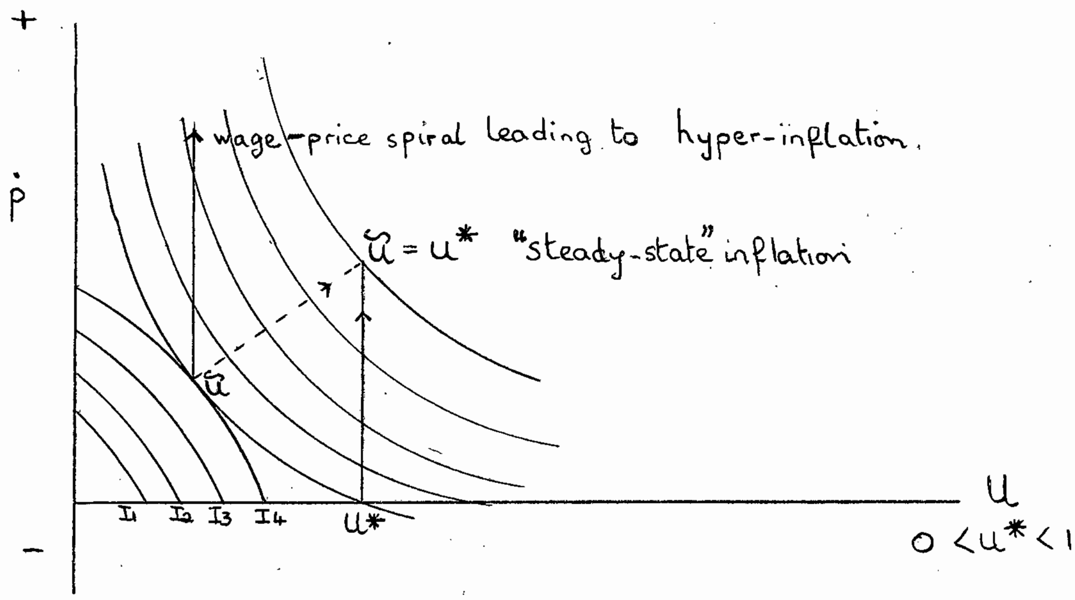
(11) R.G. LIPSEY. (1962) "Can There be a Valid Theory of Wages" Adv. Sci.

(12) EDMUND S. PHELPS "Phillips Curves, Expectations of Inflation and Optimal Unemployment Over Time". Economica. Vol 34, 1967.



u^* in the diagram is the equilibrium unemployment ratio, where the expected rate of inflation equals the actual rate of inflation so the the expected rate of inflation remains unchanged. I1, I2, I3 and I4 represent indifference curves.

If a country has come to expect inflation after a period of rising prices, it may be reasonable to conclude that the curve will move upwards. Indeed, as we shall see when we study the recent experience of the United Kingdom it is possible that this is what has occurred.

Although Phelps has developed a dynamic model which also includes an "expectations hypothesis" (13) it has been asserted by F. Brechling (14) that this hypothesis implies that "wage increases should be comparatively mild in upswings (because expected wage increases are low) and comparatively high in downswings (but this) important implication of the expectations hypothesis is not supported by most of the available empirical evidence". This hypothesis suggests

clockwise/...

(13) Op cit. pp 254-281 and in "The New Microeconomics of Inflations and Employment Theory". The American Economic Review, Papers and Proceedings. May 1969 pp 148-160.

(14) American Economic Review. Papers and Proceedings, May 1969, pp 161-167.

clockwise loops around the Phillips Curve whereas Brechling contends that most evidence in the United Kingsom and the United States points to anti-clockwise loops. Nevertheless, the prediction of the upward shift of the curve has received considerable support from Milton Friedman and the "Chicago School" of monetary economics on the grounds that inflation will be anticipated.

The debate about the significance of the Phillips Curve may, perhaps, be summed up in the words of Otto Eckstein (15) who observed that "the dispute over the existence of the Phillips Curve .... is a limited one - a disagreement about the variables that matter besides employment, and a subsidiary question about the value of the coefficient on consumer prices (included in Phillips' own model), the time profile of the effect, and the nature of the expectations process". In fairness to Phillips, moreover, it must be stressed that he conceded that his conclusions suggesting the stability of the curve, were "tentative" and remarked that "much more detailed research into the relations between unemployment, wage rates, prices and productivity" was needed.

R.G. Lipsey (16) using the same approach as Phillips but paying rather more attention to changes in the cost of living than did Phillips found only a weak relationship between wage rates and changes in cost of living before the first World War but the relationship was significantly stronger after the War. In addition his study indicated that unemployment was/......

(15) American Economic Review. Papers and Proceedings, May 1969, pp.161-167.

(16) R.G. LISPEY. op. cit. Economica Vol XXVII (1960)

was also a much stronger influence on wage rates in the nineteenth century than the twentieth century but the opposite tendency held in respect of price changes.

It is important to compare the studies by Phillips and by Lipsey with those economists who include in their investigations the influence of trade unionism. The work of Dicks-Mireaux and Dow (17), is of particular interest in this connection. Their studies showed the importance of demand for labour in the inflationary economy but they also considered the possible influence of "cost-push"factors such as the change in retail prices and what they termed "trade union pushfulness". They arrived at the conclusion that wage rates responded by about 0.5% to a change in prices of about 1%, but that wages responded by about 3½% to a change in unemployment of around 1%. The influence of "trade union pushfulness" was seen in the comparison between rate of change of wages in periods when unions tended to excercise restraint as in the period from 1948 to 1950 and in periods where this restraint was not apparent. The study concluded that the pushfulness of unions could affect the rate of change with a range of almost 5%. Accordingly the average "trade union pushfulness" could cause wage rates to increase by 2 - 2½% a year, even where there was no excess demand for labour and where the general level of prices was stable. The significance of this study as compared with those of Lipsey and Phillips is that it places emphasis on the institutional factor of trades unionism.

Subsequent/....

(17) L.A. DICKS-MIREAUX and J.C.R. DOW. "The Determinents of Wage Inflation: United Kingdom 1946 - 1956". Journal of Royal Statistical Society: Series A (General) 1959, part 2.

Subsequent to the Dicks-Mireaux and Dow investigation, Dicks-Mireaux[18] in a further study for the United Kingdom from 1946 to 1956 concluded that productivity did not appear to be a significant factor in explaining wage movements.

The work carried out by Klein and Ball[19] offers a somewhat more subjective approach in its treatment of the pushfulness of unions. Furthermore, productivity and profits were not a significant influence either on wage rates or on mark-up prices, subject, however, to certain conditions applying in what they term "pace-setting industries". They suggest in their model "the hypothesis that changes in wage rates are influenced by changes in the cost of living, by the demand for labour and by the political climate". Work carried out by two Swedish economists[20] in 1956 also suggests that the influence of "excess profits" and productivity in Sweden were not significant factors in determining wage rates.

Kaldor, on the other hand, has claimed that Phillips is incorrect in attributing to the level of unemployment or to the rate of change of unemployment, the principal cause of the rate of change of wages. He has argued that "the rise in money wages depends on the bargaining strength of labour; and bargaining strength, in turn, is closely related to the prosperity of industry, which determines both the eagerness of unions and the willingness and ability of employers to grant them".[21]

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(18) L.A. DICKS-MIREAUX "The Inter-relationship between Cost and Price Changes 1946-1959": Oxford Economic Papers October, 1961.

(19) L.R. KLEIN AND R.J. BALL: "Some econometrics of the determination of prices and wages" Economic Journal Vo. 69 (1959)

(20) BENT HANSEN AND G. REHN: "On wage drift, a problem of money wage dynamics" in Economic Essays in Honour of Erik Lindahl.

Although the profitability of industries appears to be a significant factor in wage increases in the United States, an empirical study by R.G. Lipsey and M.D. Steuer (22) suggested that the influence of profits on wage rates in the United Kingdom was small.

The study of A.G. Hines, (23) however, draws the conclusion that far greater importance should be attached to unionisation in the rate of wage change than was given in previous empirical work we have considered. If his investigation accurately reflects real world conditions it would seem clear that the importance of the institutional environment should not be under-estimated in Great Britian. It would, in addition, suggest that incomes policies may provide an appropriate answer when rapid changes in wage rates lead to inflation. Indeed Hines contends that "cost-push" factors are the main determinants of wage increases. He shows how a 1 per cent rise in retail prices is associated with a 0.7 per cent increase in wages. Moreover he also produces evidence that over the period which he examined, a 1 per rise in the degree of unionisation appears to result in a 2½ per cent rise in wage rates. His study also indicates that over time wages rates show an increasingly greater response to changes in unionisation. When comparing earnings rather than wage rates with unionisation there is a similar close relationship. The considerable significance of the unionisation factor was revealed in a recent study by Lipsey and Parkin appraising the British incomes policy. This study will be discussed in a later chapter, evaluating the British experience.

Empirical/.....

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(21) N. KALDOR: "Economic Growth and the Problems of Inflation Part II" Economica, November, 1959.

(22) R.G. LIPSEY and M.D. STEUER: "The Relation between Profits and Wage Rates". Economica, May 1961.

(23) A.G. HINES: "Trade Unions and Wage Inflation in the United Kingdom 1893-1961". Review of Economics and Statistics.

Empirical work carried out in the United States, however, appears on the whole to show a closer relationship between profits and wage rates or earnings than has been noticeable in the United Kingdom. Two interesting studies were those by Eckstein and Wilson[24] and by Bhattia.[25] The former found that there was "only weak evidence that unionisation affects the long run level of wages". Nevertheless they also find that wages in "a group of heavy industries, which we call the key group, move virtually identically because of the economic, political and interdependance among the companies and the unions in these industries". Moreover they add that "wages in the key group are explained by the profit rates and the unemployment rates in the group. Wages in some other industries outside this groups are largely determined by spill-over effects of the key group wages and economic variable applicable to the industry". Eckstein and Wilson consider that both political as well as economic factors play a part in wage determination and contend that the importance of political factors "is implicit in the hypothesis of the key group and the wage round .....(as) .... political relationships among unions are... close within this group". Specifically they found that a 1 per cent change in the rate of profit and a similar percentage change in the level of unemployment were associated with a change in earnings of approximately 0.6 to 0.7 per cent a year. They did not find any correlation between profits and unemployment. In the study by Bhattia approximately 80 per cent of the change in earnings was attributed to the rate of profit. In an earlier study he had shown that

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(24) OTTO ECKSTEIN and THOMAS A. WILSON: "The Determination of Money Wages in American Industry". Quarterly Journal of Economics. August 1962.

(25) R.J.BHATTIA: "Profits and the Rate of Change in Money Earnings in the United States, 1935-1959" Economica Aug.1962.

unemployment did not explain more than about a quarter of the change in wages. As far as the United States was concerned he considered the term "profit-push" more appropriate than "wage-push". Other studies by Perry, by Klein and Bodkin and by Schultze and Tyron have introduced a combination of different variables to explain wage changes. Although it is not possible to draw any firm and precise conclusions from all the empirical work carried out, it would seem that the rates of profit and rate of price increases are relatively more significant in the United States than in the United Kingdom. Finally it is worth observing that following in the wake of Phillips and Dicks-Mireaux and Dow in the United Kingdom , economists in the United States have tried to establish what the level of unemployment would be in order to achieve price stability. Indications are that it would be higher than in the United Kingdom; possibly around 5 to 6 per cent. as opposed to Phillips' estimate of $2\frac{1}{2}$ per cent, but as would be expected the results are not conclusive although actual experience in the United States in the first half of the 1960s would not seem to provide strong evidence against such a conclusion. We have been reminded recently however, by B.J. McCormick (26) that "in one memorable investigation by Bodkin it was discovered that wage stability in the United States could be obtained if 17 per cent of the labour force was unemployed. Such a finding", he adds, "suggests that economics has returned to its nineteenth century role as 'the dismal science'.

Before/....

(26) B.J. MCCORMICK: "Wages": Penguin Modern Economics 1969. p. 154.

Before concluding this admittedly brief and somewhat sketchy survey of some of the empirical work that has been carried out during the past fifteen years, it would be appropriate to consider the model developed by Godley and Shepherd which they first explained in 1964[27] and which was slightly modified in 1968.[28] We indicated in the introduction that the British Treasury appears to place considerable reliance on this model for its economic forecasts, and as we shall be dealing in some detail with the incomes policy in that country, the relationship between unemployment and output as described by the model merits examination. We shall see that the model appears to support the contentions by Professor F.W. Paish that a level of unemployment of about 2½ per cent is required to maintain price stability in the United Kingdom. Moreover, the compulsory incomes policy initiated during the Labour Government's Administration does not appear to have reduced this percentage. Paish therefore concludes that the policy failed. A more detailed consideration of Professor Paish's arguments will be attempted in a later chapter after the development of the British incomes policy has been described.

Shepherd[28] asserts that "essentially the model consists of relationships whereby the level of employment and unemployment can be predicted if certain pre-determined variables are known. The most important ....is the volume of total output (gross product). However, the availability of labour is also important and the 'supply of labour' and

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(27) W.A.H. GODLEY and J.R. SHEPHERD: "Long-term Growth and Short-term Policy". National Institute Economic Review No. 29, August, 1964.

(28) J.R. SHEPHERD: "Productive Potential and the Demand for Labour" Economic Trends No. 178. August 1968. pp XXV - XXVII.

the level of normal working hours are essential pre-determined variables". Shepherd defines the 'supply of labour' as "a measure of the number of individuals who are able and willing to work". This is not the same as the statistical series for working population which consist of employed plus registered unemployed because the working population "is known to be affected by the state of demand for labour as well as by the supply. The labour supply is therefore defined as the level of employment that would occur concurrently with a given level of unemployment". This implies that when certain employees loose their jobs they will not seek employment. Some housewives, for example, may only accept employment when there is a strong demand for their services in industry and will therefore not register as unemployed if their services are terminated. Shepherd concedes that the labour supply as defined cannot be "directly measured, but changes can be estimated by the use of the observed relationship between employment and unemployment". He asserts that it can be shown statistically that "cyclical fluctuations in employment are substantially greater than the corresponding fluctuation in unemployment .... The (very approximate) estimates derived from the equations suggest that with a low level of unemployment (say 300 thousand) an increase of one thousand in unemployment is associated with a reduction of about $2\frac{1}{2}$ thousand in employment in relation to the labour supply. With a higher level of unemployment (say 500 thousand) this figure is about $1\frac{1}{2}$ thousand". The employment - unemployment relationship as described accordingly "postulates that with employment growing at the same rate as the labour supply, unemployment will remain constant".

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The model introduces the concept of productive potential which is defined as "the output associated with a given intensity of labour utilisation". Changes in the labour supply, however, affect the productive potential because they will affect output. "Given the relationship between employment and unemployment", Shepherd states that "at the margin, an increase of 1 per cent in output gives rise to a fall of about 1/5 per cent in unemployment when unemployment is already low (300 thousand), but to a larger fall of about $\frac{1}{3}$ per cent when unemployment is somewhat higher (500 thousand)".

(29) Paish uses this relationship between unemployment and output to illustrate his contention that a margin of spare capacity is required to avoid inflation. He observes that "if we interpret an increase of 1 per cent in output as the equivalent to a fall of 1 per cent in the margin of unused potential and, assume a ratio of 1 to $\frac{1}{4}$ at intermediate levels of unemployment we can construct ...... a rough scale between various percentage margins of unused potential and the equivalent percentages of unemployment". Paish then combines this scale with a relationship between levels of unemployment and percentage increases in income from employment and is thus able to show that with a margin of spare capacity of about 6 per cent the annual increase in incomes from employment (after allowing for time lags) will be about 4 per cent. If productive potential is growing at the rate of 4 per cent the equivalent level of unemployment will be about $2\frac{1}{2}$ per cent. Paish therefore concludes that "so long as the growth of productive potential is maintained at its present rate, this seems to be the lowest level of unemployment which is, in the long run, compatable with an absence of inflation".

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(29) F.W. PAISH: "The Rise and Fall of Incomes Policy" Institute of Economic Affairs. Hobart Paper. No. 47. pp 40-41.

He remarks that 1958 and 1967 were the only years in which the rate of increase in income from employment slowed down to equality with the rate of growth of productive potential and during these years unemployment was about $2\frac{1}{2}$ per cent. The experience in the United Kingdom from 1968 to 1970 provides evidence, however, that the relatively stable relationship between the level of unemployment and the rate of change in wages observed by Phillips and Paish as well as other economists, may be changing. We have touched on this aspect already but will need to return to it at a later stage. Paish in particular, has views upon this change which require consideration.

The discussion in this chapter has, perhaps, been sufficient to highlight the wide range of conclusions drawn from the investigations conducted and the relative importance attached to the various factors in the wage and price mechanism. From the conflict of evidence that has been forthcoming it is surely clear that a government should be extremely careful when it adopts policies which over-ride the market mechanism by the imposition of direct controls on wages, profits and prices.

In the following chapter we propose to consider the type of problems with which the authoritites having the responsibility of formulating incomes policies will be confronted. In particular, we shall look at some of the mechanisms which may be built into an incomes policy model to control increases in incomes without at the same time causing serious distortions which would greatly detract from the advantages than an incomes policy might have to offer.

Although/....

Although the economic conditions in a country may seem to justify direct intervention by the State, the criteria used to decide increases in different types of incomes as well as the administrative mechanism for applying whatever criteria are agreed upon, must be worked out with great care. If they are not, the country may find that the cure is worse than the disease. In subsequent chapters a survey of the incomes policies in the United Kingdom and the Netherlands will be attempted with a view to assessing what success they have had in controlling the rate of inflation.

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CHAPTER III

We asserted earlier when defining incomes policies that they should include some mandatory provision to ensure that their conditions are complied with. Notwithstanding this assertion, with which we have no reason to find fault, it is intended to begin this chapter by looking at policies, generally referred to as "guide posts", "guide-lines" or "guiding lights". Such policies may, but usually do not, include legislative power to make the guide-lines effective. Indeed, where guides are stated only in general terms it is, as we shall see, very difficult to give them effective legislative backing. A discussion on guide-lines should help to appreciate why compulsion is usually an essential requisite of an incomes policy.

It is also necessary to preface any discussion on the problems of formulating and applying an incomes policy by again emphasising that the specific economic conditions existing at a particular time in a country are of fundamental importance in deciding the type of economic mechanisms to be built into the policy. We cannot but agree with R.J. Ball that "details of any particular policy cannot possibly be discussed without reference to a set of specific institutional conditions". We shall, of course, later be dealing specifically with the experiences of Holland and the United Kingdom. Moreover, certain circumstances existing in Scandanavian countries will be studied. Before analysing the application of a specific policy in the real world, some general consideration of the practical issues likely to be encountered is not without relevance.

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(1) R.J. BALL: "Inflation and the Theory of Money". p. 300.

The "guiding light" policy for incomes is usually seen simply as an exhortation or expression by the government to independant decision-making units, groups or sectors as to what increases in wages, or in other incomes are considered by the administration to be compatable with price stability. In the United States, for example, government bodies and the President himself, have from time to time made exhortations both to specific industries as well as to the general public and the business community to avoid inflationary wage and price increases. It is doubtful whether such "moral suasion" has had any very material effect. They appear to be regarded more as pious hopes expressed to show official concern rather than requests intended to influence decision-makers in industry. In 1964, President Johnson in his "Economic Report of the President" said -

> "I shall keep a close watch on price and wage developments, with the aid of an early warning system which is being set up in the appropriate agencies. I shall not hesitate to draw public attention to major actions by either business or labor that flout the public interest in non-inflationary price and wage standards".

Notably absent was any real threat to impose compulsory restraint except through anti-trust legislation or unlawful price-fixing methods, or threats to release stock-piles.

Earlier/...

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(2) "ECONOMIC REPORT OF THE PRESIDENT": 1964 p. 11

Earlier, in 1962, the Council of Economic Advisers in the United States, formulated what was referred to as a "guide-post" for wage adjustment. In its Report the Council stated that the "general guide for non-inflationary wage behaviour is that the rate of increase in wage rates (including fringe benefits) in each industry be equal to the trend rate of overall productivity increase". The Report continued by saying that the "general acceptance of this guide would maintain stability of labor cost per unit of out-put for the economy as a whole - though not, of course, for individual industries". In April 1962 the steel industry negotiated a wage contract which J.K. Galbraith (3) observed was "generally consistent with these standards". The steel companies then announced an increase in steel prices. However, Galbraith states that "strong government pressure, strongly adverse public and business opinion and some historic Presidential invective brough a recision of the increases. Thereafter, for several years", he asserts, "the wage guide-posts, as they came to be called, and the counterpart price behaviour were a reasonably accepted feature of government policy. Wage negotiations were closely consistent with the guidelines. Prices of manufactured goods were stable". Notwithstanding Galbraith's remarks it is not clear to what extent the pressure by the government as distinct from business and public opinion was influencial in the recision of the prices. Moreover, it does not necessarily follow that the stability of prices and the terms of subsequent wage agreements were a result of the guide-lines set

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(3) J.K. GALBRAITH: "The New Industrial State". p. 257.

out by the Kennedy Administration. There may be no strong causal relationship. However, "jawboning" as this type of government pressure came to be called was thought to have had some effect on price and wage increases. It is difficult to establish the extent of its influence on industry. The Republican Administration which succeeded President Johnson, did not continue "jawboning" but President Nixon's "inflation alerts" may, in practice, prove to be of a somewhat similar character.

The establishment of some form of "guide" is, accordingly, intended normally to provide a target figure for "the increase in aggregate money income to be permitted in a given year".[4] This increase would naturally depend on the increase in aggregate productivity of the economy so that there would be no rise in the general price level. The authorities may hope that industry will pay some attention to the guide-lines if they are accompanied by threats of increased taxation or the more severe use of monetary weapons. The government may endeavour to set an example in its reaction to wage claims in the public sector as it is a large employer of labour. Such an example was provided by the "pay pause" in the United Kingdom which was enunciated in July 1961 and which preceded the "Guiding Light" of the following year when a maximum increase in wages of 2 to 2½ per cent was set as a target. This percentage was the official forecast of what the increase in productivity would be in 1962. It was remarked by one economist[5] that the

actual/...

(4) R.J. BALL: op cit. p. 293

(5) JOHN B. WOOD: "Labour Management and Economic Growth", 1967.

actual increase in productivity turned out to be zero but wages and salaries had by then risen by 4.2 per cent". Despite official Prime Ministerial condemnation of certain large wage increases at the time, the Treasury itself granted an increase for administrative civil servants substantially above the target figure and the same economist adds dryly that the Guiding Light "was thereby firmly put out".

Probably the most damaging criticism of policies included under the "Guiding Light" variety is that they do not answer the crucial question of how wages and other incomes are to be adjusted in various industries, or even different plants, which have different productivities. It has been pointed out by the critics of government attempts to control aggregate incomes in this manner, that no solution is provided for the unavoidable problem that if all incomes are to rise by the same percentage, those in efficient firms will grow at a slower rate than productivity while those in inefficient firms will grow at a faster rate than productivity. Quite apart from the dissatisfaction this is likely to cause in efficient firms, there also needs to be some effective method of dispersing the gains in fast growing industries over the whole of the economy. This might be done through lowering prices or even by the taxation of "excessive" profits if some profit norm can be determined. But this whole issue is often ignored by the supporters of guide-posts that are concerned only with aggregates. This criticism would seem to highlight a major defect and requires a satisfactory answer before general guidelines, as we have described them, are likely to have any significant effect in restraining increases in incomes. At the most, they may provide some guidance to official

arbitrators/...

arbitrators considering disputes over claims for higher wages. In short, a clearly defined policy is needed for relative incomes, not merely for total incomes. As we shall see when examining the Dutch experience a policy for relative incomes requires a vast wealth of detailed information to calculate how each wage should be fixed and, moreover, how such a policy, if mandatory, can be adequately "policed", so that it will not be undermined by wage drift, "black wages" or other inducements.

As government exhortations combined with voluntary targets did not seem to have a moderating effect on wage and price increases they had to be transformed, in the United Kingdom, into policies permitting direct government intervention. This occurred in 1966 as an immediate result of the economic crisis in that year. At a later period they were, as we shall see, largely relaxed.

When a government has decided that direct intervention in wage and price determination is necessary, whether as a short-term or long-term policy it is immediately faced with a host of issues which need an answer. We propose, therefore, to look at the most important of these issues in the remaining part of this chapter. Firstly, we shall consider wages as distinct from non-wage incomes.

Initially, the State must decide whether the existing wage structure, as it stands at a particular time, should, by and large be preserved. It must endeavour to determine whether the rates and the differentials as they have been established in the labour market, no matter how imperfect, are beneficial not detrimental to the economic goals the government has set itself. For example, if a union has through its monopoly power, however exercised, succeeded in acquiring wage

increases/.....

increases far in excess of those that would prevail if conditions in the labour market were more competitive, should such increases be allowed to stand? Moreover, is it a practical proposition to try and establish what rates would be in a competitive market for labour? How indeed would this be done except by legislating against all restrictive practices on both sides of industry and prohibiting "closed shop" conditions. Is such a drastic legislative change really feasible even if it were economically desirable? The social climate and attitudes of labour leaders and union members would be crucial. Unions would not willingly see a diminution of their bargaining power unless employers were similarly treated and non-wage incomes also came within the ambit of direct control by the State. Thus it is hardly a feasible political policy to attempt to make competitive conditions prevail in respect of the supply of labour if the employers, in key industries in particular, are permitted to retain their monopsony powers.

If the existing wage structure is not inherently undesirable economically and if the differentials in particular skills are considered to be justifiable in terms of job evaluation techniques, then an incomes policy starts from a firmer platform politically. In Holland, the wage differentials established between skilled, semi-skilled and unskilled labour were roughly what existed before the incomes policy was introduced after the Second World War. If the State approves of the existing differentials, is it then to attempt to ignore subsequent pressure for (further) increases in the differentials resulting from the market demand for the services of labour? If certain industries are expanding faster than others and wish to attract labour should they be denied the right to pay higher wages

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for similar work? If they are denied this right how is labour to be allocated to where labour is most needed in the national interest and most in demand? Furthermore, unless the State undertakes the direction of labour by some form of compulsion, as in wartime, how much longer can inefficient industries or firms survive simply because they do not have to face competition from efficient firms offering relatively higher wages? Thus the notion of "social justice" or "social equity" inherent in the concept of "solidarity", namely, the rate for the job which is unaffected by market conditions, may not easily be maintained in the face of a growing demand for labour of a particular kind in specific industries which are prepared to pay higher rates. If the concept of "solidarity" is not retained what criteria, then, is to be substituted? Is the "status quo" to remain? It has been suggested often enough by economists that wages should be increased proportionally to increases in productivity. If this is so then either this is done on an aggregate basis for the economy as a whole, and we have seen how unsuitable this policy is when considering the guiding light approach, or it is to be carried out on the basis of productivity in specific industries or even in specific plants. Whichever approach is adopted it is necessary to formulate an accurate measure of productivity and of labour productivity, namely, output per worker, in particular. Turner and Zoeteweij (6) note "that there are many concepts of labour productivity for the economy as a whole. On the output side one may consider gross or net physical output per man-hour, one may include or exclude production for purely military purposes. On the input side", they continue, "labour may be measured in terms of unweighted man-hours (which take

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(6) H.A. TURNER and H. ZOETEWEIJ: op cit. p. 115

no account of differences in quality or skill), or in terms of weighted man-hours (that is, allowing for differences in individual earnings taken as an indicator of differences in skill)". They rightly point out that the two methods give quite different results and cite examples from the United States and France to illustrate this point. Moreover they contend that "it is because a weighted labour input index .....tends to rise faster than an unweighted one that a productivity index using weights rises less than an unweighted one. But this", they claim, "is appropriate for an index used for a productivity criterion of wage policy because while structural shifts in manpower will normally result in a rise in the total output index, there is no corresponding scope for wage increases, the shift of labour to better paying industries or occupations itself having already resulted in a rise in the wage level. So raising wage rates in the same proportion as a national productivity index calculated with unweighted labour input would tend to lead to increases in labour costs".

If aggregate labour productivity is forecast to rise by say $3\frac{1}{2}$ per cent and wages and salaries are also permitted to rise by a similar percentage the next question, as touched on earlier, is to decide how the total increase in wages is to be spread over various sectors and industries growing at differing rates of productivity. Even assuming that productivity can be accurately measured and this is particularly difficult in certain categories of work such as teaching, the medical profession and sections of the civil service such as the police and the armed forces, reliance would have to be placed, at least to some extent, on job evaluation studies. In order to encourage innovation, by the removal of restrictive practices and other obstacles to growth, workers

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(and indeed the owners of capital as well) should surely be permitted to enjoy some of the fruits of their increased productivity and not merely to share equally with other sectors which have shown less growth in productivity or no growth at all. Many economists, however, would claim that it would be wrong for each sector or industry to retain for itself the whole fruits of productivity increase, especially as the imperfection in the market for labour services and in the market for the commoditites they produce would distort the wage structure unjustifiably if aggregate wage increases were determined by the State. They argue that such a practice would be more inequitable than any situation prevailing under free collective bargaining despite the fact that organised labour in free collective bargaining may exercise its monopoly power at the expense of unorganised labour. It would seem that some compromise would need to be achieved both to encourage the increase of productivity, to attract labour to where it is needed, and at the same time to ensure that not all the advantages were retained by the sector achieving productivity gains. Accordingly, as intimated earlier when discussing guide-posts, a measure of price control might be an appropriate answer if combined with some acceptable formula for sharing out productivity increases to other groups not so fortunately placed to enjoy productivity gains. Thus the concept of social justice inevitably intrudes into the policy criteria in the form of an equitable minimum wage based on minimum living standards or a wage that is regarded as socially acceptable for a certain type of job. But just as the economy may wish to attract labour to certain sectors so too it may wish to attract private capital. Therefore the determination of the returns to the owners of capital must be taken into account if growth is to be promoted by the direct intervention of the state. The

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institution of a non-wage incomes policy to prevent inflation must not be allowed to inhibit economic growth (particularly in the crucial export sectors) by discouraging private capital investment and entrepreneurship.

It has been pointed out by P. Streeten[7] and other economists in the United Kingdom, that if increases in incomes are related only to productivity increases in industries achieving them (so that if a sector achieves no growth of productivity no increase is justified) this in itself does not mean price stability in the economy. Workers getting wage increases will spend some of their wage increases on products from industries where there have been no productivity gains. There will therefore be a rise in demand for labour in the latter sectors. If wage increases are not permitted in these sectors they may fail to attract labour, and unless there is price control, prices of their goods will rise as there will be a shortage. If wages and prices in the static industries rise, the aggregate price level will also rise. Thus once again it is probably necessary to determine the aggregate permissible increase in incomes and then determine how this is to be shared out between various claimants. As prices are often sticky downwards in the short-term at least, price reductions while desirable in an efficient industry may be difficult to achieve in practice. A further complication is that productivity besides being difficult to measure may be subject to substantial fluctuations. Indeed, there may be an absolute decline in productivity in some sectors, but it is highly unlikely that unions in such a sector would countenance any reduction in money wages

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(7) P. STREETEN: "Wages, Prices and Productivity". Kyklos Vol 15 (1962) pp 723 - 731

as a result, even if the measure of productivity were output per head.

The designers of an incomes policy for wages will be confronted immediately with the practical issues of determining whether wage changes are really instrumental in attracting labour from one sector to another. If they are instrumental how much weight should be attached to them? In the last fifteen years work carried out on labour mobility has suggested that wage differentials to attract workers from one industry to another or from one firm to another are much less significant than was previously thought to be the case. The so-called "job-vacancy" hypothesis has received a good deal of attention in recent years in this connection. Professor P. de Wolff stated in the O.E.C.D. Report (8) on wages and labour mobility that "the most important finding of the Expert Group's report is that in the labour markets and periods studied, large short-term changes in relative earnings do not seem to have been necessary to bring about substantial changes in the pattern of employment". Although the findings showed that "in a number of countries there has been a tendency, when industries are studied in fairly aggregative groupings, for wages to rise faster in branches which were increasing their share of the labour force ......this should not generally be interpreted as a causal relationship". The study "clarifies the way in which expanding industries have in fact generally been able to increase numbers as required through the attractive force of new job vacancies opening up within the framework of the existing wage structure".

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(8) "WAGES AND LABOUR MOBILITY". O.E.C.D. 1965 p. 9

The Report, however, does not suggest that changes in wages are never necessary to bring about a re-allocation of labour, and indeed, suggests some specific instances where such changes may be required, such as attracting labour to remote areas where the existing supplies of labour are insufficient. Another example cited is the case of teachers and nurses and similar occupations which require relatively long training periods so that, in the short term, at any rate, supply is not responsive to changes in demand. The Report furthermore admits that the "everyday knowledge of employers sometimes raising wages to attract or retain labour", suggests that labour is sensitive to wage changes and could even be said to be so sensitive that a very small change in wages leads to a large movement of labour. On the whole, however, they have been led to believe that "with some important exceptions, it is the wage-insensitive explanation that applies ....(as) ....

(i) the observed changes in the allocation of labour are often brought about by mechanisms other than changes in the wage structure, and

(ii) the observed changes in the wage structure are often brought about by forces other than those that allocate labour".

Earlier W.B. Reddaway (9) also produced empirical studies suggesting that the "job vacancy" hypothesis was a more satisfactory explanation of labour movements than wage changes. His view is, he admits, "tentative and he adds that "the most one can conclude is that it is probably not worth while to undertake a difficult campaign to induce wage negotiators

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(9) W.B. REDDAWAY: "Wage Flexibility and the Distribution of Labour". LLoyds Bank Review. (1959).

to change their practices, when the redistribution seems to be obtainable without such a campaign, largely via the (socially more acceptable) route of varying job opportunities".

If these studies are basically correct in their conclusions they do certainly make the imposition and administration of a government wage policy a lot easier, because as McCormick (10) remarks it means "that an incomes policy need not concern itself with the allocative aspect of wages". In addition, it might be more worth while for a government to concentrate on encouraging labour mobility through providing efficient information services about jobs, through better educational and re-training schemes where necessary, and furthermore by helping to counteract the ignorance, inertia and the unnecessary restrictions on entry into jobs.

It is appropriate at this juncture to concern ourselves with non-wage incomes. Quite apart from whether a strict control over non-wage incomes is economically desirable, it is unlikely that a statutory incomes policy would ever gain acceptance by labour unless the policy included non-wage incomes. Non-wage incomes can, apart from higher rates of tax, be subject to control in the form of interest rate ceilings, dividend limitations, rent control, or price control. Although the "freezing" of dividend payments and rents, for example, may be regarded politically as a "quid pro quo" to the unions in return for restrictions on their bargaining power, controls over non-wage incomes present a number of serious economic problems as distinct from social aspects.

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(10) B.J. McCORMICK: "Wages". Penguin Modern Economics p. 36. He also points out, however, that the job vacancy hypothesis is inconclusive as it failed to specify whether employers in an industry would wish to retain the labour which was offered new jobs in other industries.

Firstly, there is the difficulty of deciding upon economically sound criteria for limiting increases in profits, prices and rents. Paish[11] discards any proposal for the direct limitation of profits. "To try to peg profit margins" he contends "would mean that every firm would be working on a cost-plus basis and would lose all incentive to keep down costs". But what after all, are profits? R.C. Tress[12] has pointed out that the National Incomes Commission established by the Conservative Administration on 1962 addressed itself to this problem and defined profits as being "the contingent reward for the capital invested in a business, for the risks that have been accepted in earning the profits and for the skill and enterprise with which the affairs of the business have been conducted". Moreover, the Commission explained that "profits are a contingent receipt not a contractual one", and that "they arise from a collection of causes for which a unit of reference is difficult to find" and furthermore, that "profits vary between one firm and another to a notably greater extent than do the other categories of earnings in industry". The criteria for deciding on rates of profit are therefore far less easily established than salaries and wages. If innovation and enterprise are to be encouraged then the opportunity to earn high rates of profit if greater risks are undertaken must be accepted. Tress suggests that there are three components making up "the notion of profits as an incentive to enterprise and innovation". The first component is the abnormally high rate per unit of output obtainable for a relatively short period through seizing an opportunity. Secondly there is the "rate of profit per unit of output that comes to be established as

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(11) F.W. PAISH: "Policy for Incomes"? op cit. p. 20

(12) R.C. TRESS: op cit. p. 694.

normal within a particular line of production". Finally there is the "volume of sales in any period which in the determination of aggregate net receipts, is the multiple of the rate of profit, whether in the first or the second of the above two definitions".

Although the first definition of profits should not be disregarded, Tress suggests that the second definition probably "provides the main source of profit earning and that therein the origin of the rate of profit per unit of output (though not of sales and therefore of aggregate profit) is much more the product of convention". If this is so and it is by no means conclusive, the norm, whatever it may be for a particular industry or line of production, could be maintained by the State intervening not to control profits, but rather by controlling prices. However it must surely be conceded that, except as a relatively short-term expedient, such action may cause distortions in the economy where capital is privately owned and is used where it can obtain the best available return. The problem of rent control in countries where it has been imposed has resulted, not infrequently, in private capital no longer being supplied for residential housing in the quantity which is needed to satisfy the demand for housing. Entrepreneurs concern themselves with future expectations. They will not lightly commit capital to, say, new residential buildings which, while not presently rent-controlled may find them subject to control before long. There is indeed no easy answer to the problems arising from the control of non-wage incomes. The establishment of profit norms in the real world would seem to be a hazardous task as it involves the valuing of capital, itself an exceedingly difficult undertaking as peoples' expectations of the future are forever changing. While direct control of prices and profits may be a short-term necessity, it is doubtful if it is a desirable long-term objective except through the more indirect methods of fiscal policy in its taxation of profits or some portion

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of profits such as distributed profits or "excessive" profits. Paish has,[13] however, provided some cogent reasons against taxing "extra" profits at a higher rate or of distinguishing between distributable profits and retained profits in fiscal policy. In the first instance he points out that a high rate of profits tax does not affect "the inefficient firm which is only just managing to stay in business, while it increases the difficulty of efficient firms in obtaining the finance they need for expansion". Moreover it also reduces the incentive to keep down costs as indicated earlier. On the other hand taxing distributed profits at a higher rate than retained profits means that the fast growing efficient firm will be unable or will find increased difficulty in obtaining finance in the open market to augment its own retained profits. Slow-growing firms who do not really need most of the profits they make will be less inclined to distribute dividends. Thus the net result may well be to discourage initiative, efficiency and innovation and preserve a relatively undynamic economy. Price control is probably a preferable way to control non-wage incomes that the direct intervention in the fixing of profit rates. Indeed, price supervision or price controls of some kind, have existed in mixed economies for relatively long periods in peacetime conditions.

The discussion of the control of non-wage incomes either directly or through the control of prices has so far tended to imply that although price control is politically feasible it is economically both unnecessary and undersirable. Are there no sound economic grounds for controlling prices as a means of controlling inflation? By itself price control may merely "suppress" inflation or encourage black markets, but if used in conjunction with other economic measures has it some economic justification?/...

(13) F.W. PAISH "Policy for Incomes". op cit. p. 20.

justification? In periods of national crisis such as during a war, it has been pointed out by Phelps Brown[(14)] that "Governments commonly find that the process of the market place will not unaided achieve the sudden and massive transfers of resources to new uses that the switch from a peace to a war economy demands: other means must also be used .... Higher rents could not have the same effect on long-run supply as in a free market, since the Government will not allow the necessary movement of factors into the building industry. They would" asserts Phelps Brown, "simply increase the incomes of landlords, and reduce the real incomes of those people who have moved into the area because directed to do so". This argument, however, is not applicable to normal peacetime conditions.

The O.E.C.D. Report entitled "Policies for Prices, Profits and other Non-Wage Incomes"[(15)] suggests that a case for controlling non-wage incomes may be made if the behaviour of profits and other non-wage incomes is "an important cause of rising prices, either in isolation or in supporting and reinforcing a rise in wages .... The authoritites in many countries feel that the most appropriate complement to a wages policy is an active price policy". The Report refers to the authors of "The Problem of Rising Prices"[(16)] who held that non-wage incomes can be an independant cause of cost inflation. They consider that this may occur, even though producers may tend to use their market power primarily at times when demand is rising or costs are increasing.

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(14) E.H. PHELPS BROWN: "A Course in Applied Economics". p. 227

(15) O.E.C.D. (1964) pp 15-22

(16) Op cit.

However, they qualify their statement by adding that, "in our judgment, the problem of inflation from administered prices would be minor if a situation were reached in which average wage increases were confined to the limit allowed by the average increase in productivity and excess demand pressure were avoided".

The conditions existing in important areas of the private sector in Western economies tend to make effective price competition difficult to achieve. This tendency may be increasing. The tentative conclusions reached by the O.E.C.D. Report in 1964 seem to represent a fair assessment of the situation. While admitting that a degree of competition is a common feature of such economies they observe that "there are many sectors where prices are in some sense 'administered'. The existence of administered prices" they continue, "is at least a potential cause of cost inflation. It would seem more particularly in sheltered industries that whereas cost increases tend to be passed on immediately and fully in higher prices, cost reductions are often only passed on incompletely or after some delay. This may well be a significant part of the process by which costs and prices are levered up under conditions of cost inflation." However, as we pointed out in Chapter II, even if prices are administered and a wage-price spiral develops, it still requires an expansionary monetary policy to sustain it.

The reasons why a government may prefer an active price policy to other indirect measures such as fiscal and monetary instruments, are partly political, partly administrative and partly economic. Firstly, it is probably easier for the general public to understand a policy directly related to prices. Secondly, it is easier for the authorities to ascertain what is happening to prices than it is for them to discern rapidly the

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trend of profits in specific industries or sectors. Thirdly, as the O.E.C.D. Report asserts, "framing policy in terms of prices rather than profits seems to get round many of the difficulties that arise from the fact that profits are a residual, and hence fluctuate quite sharply with the level of activity and sales". Nevertheless, policing a comprehensive price policy may raise major difficulties. In addition, a large measure of market intervention by the authorities may, as already suggested, prove to be economically harmful by causing undesirable distortions in the economy.

In view of the nature of modern mixed economies some degree of price control may be justified on economic grounds to help reduce inflation, but as intimated earlier, it is a weapon to be used with great caution. Preferably it should be accepted only as a short-term measure. If price control is held to be unavoidable, it must, of course, be sensitively and imaginatively handled. There is always a considerable risk that the controls will be clumsily applied if the controllers have little sympathy for or understanding of business policy and entrepreneurial motivation. Where possible, alternative measures should be adopted. For example, subsidising particular members of the community seriously affected by the removal of price control may offer a sounder economic solution to the problem, especially in the case of rents for residential housing.

It is worth noting that Paish[17] has contended if prices were fixed at levels which would provide normal profits at an agreed level of wages for a reasonably efficient firm, this would frustrate the whole purpose of the operation of an incomes policy which is to maintain a high/....

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(17) F.W. PAISH: "Policy for Incomes?" op cit. p. 20

high level of employment with price stability. "Unemployment", he observes, "can be kept abnormally low, only by keeping the demand for labour abnormally high, and the demand for labour can be kept abnormally high only by keeping the employment of labour abnormally profitable. If profits are held down to the same level as would prevail in a competitive market, the demand for labour will be correspondingly restrained and unemployment will not fall".

We have considered so far in this chapter the various possible criteria to be built into the framework of the incomes policy and they have provided a number of intractable problems. Something must now be said of the sort of administrative mechanisms that are needed in order to make the criteria effective. How are demands for wage increases to be processed? What will be the machinery for wage negotiation? If prices are to be controlled, what machinery is necessary for considering price increases? Will the organisations set up by the State be tripartite in that the State will act in co-operation with both sides of industry? Will some type of "early-warning system" for price and wage increases be instituted? If so, will it apply to all prices and all wages, and if only to certain prices and wages to which will the "early warning system" apply?

The institutional framework for collective bargaining may be an integral part of an incomes policy in so far as it may serve to centralize wage negotiation between both sides of industry and to ensure not only that the agreements are facilitated, but also that they are more likely to be enforced. This is not inevitable as wage drift may be more likely to develop at plant level as a result of central negotiation.

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Where there is already in existence a relatively centralised system of wage negotiation it may be much easier for the State to intervene in the bargaining process or to form a third party to the discussions. Even if the State does not take part in the actual negotiations, either as an interested party or as a mediator or an arbitrator, central negotiation may proceed subject to the proviso that any agreement may be subject to review and approval by a State institution which may or may not include at least some representatives from industry. In the Scandinavian countries there is a high degree of central negotiation as compared with the United Kingdom. However, the Scandinavian countries do not, unlike the Netherlands and until recently, the United Kingdom, have a comprehensive system of price and wage controls, although Norway still retains a greater control over prices than does Sweden and Denmark. Price and wage "freezes" have been imposed in Denmark and France but a properly worked out incomes policy as defined in an earlier chapter has not formed part of this control in either country. The "freeze" was looked upon as only a short term measure to deal with a crisis situation created largely as a result of a deteriorating balance of payments.

In the Netherlands, partly by reason of its own social and political development and institutional structure, "it has in general been possible to achieve a high degree of concerted action among both the employers and the trade union federations".(18)

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(18) TURNER AND ZOETEWEIJ: op cit p. 104.

Where collective bargaining is unsuccessful in arriving at an agreement there may be legislative provisions for mediation or arbitration. Arbitration may be employed to decide how much of the proposed increase in wages is justified, if there is a dispute as to the extent of the increase in productivity. This may apply where, for example, legislation provides specifically for arbitration in cases where permissible norms are exceeded. Alternatively, legislation may simply offer a useful means of ending industrial disputes without making any attempt to relate increases to any government incomes policy. Arbitration has been used extensively in Australia and New Zealand for a long time. Turner and Zoeteweij[(19)] point out, however, that although the formal purpose of the system of arbitration in Australia is "to avoid industrial unrest and to dispense justice, the awards are made with explicit reference to the country's economic and social conditions". They observe that "the indicators used for assessing these conditions include, for example, data relating to employment, investment, production and foreign trade". In New Zealand the Court of Arbitration "may make general wage orders by which the rate of remuneration fixed in all awards and industrial agreements in operation may be changed .... These orders affect wages throughout the economy and must be based on a number of national economic and social indicators that are specified in the (relevant) act".

It is therefore, essential to pay attention not only to the criteria for changes in prices and incomes but also to the mechanisms required to administer the criteria selected. If the government of the day is accepted as genuinely having the interest of the community at heart

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(19) TURNER AND ZOETEWEIJ: op cit pp 108-109

rather than of being biased in favour of a particular sector or group, the community are much more likely not to resent the government, giving itself powers of direct intervention. The climate of political sentiment and of trust is of the greatest importance if a compulsory incomes policy is to be established either as a long-term or even as a short-term policy for controlling inflation.

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C H A P T E R IV.

Direct intervention by the state in the control of prices and wages is not peculiar to the Twentieth Century. In Roman Times, for example, Diocletian endeavoured, seemingly without a great deal of success, to restrict the increase in the prices of certain goods. So did Charlemagne. In a much later period, in England, as a result of the Black Death and the shortage of labour, an Ordinance in 1349 and the Statute of Labourers in 1351 attempted to reimpose "pre-plague wage rates" throughout the country. Between 1351 and 1377 "about 9000 cases of breach of the prices and incomes policy were heard .... and discontentment was widespread".[1] This attempt at an incomes policy in Medieval times was undoutedly one of the causes of the Peasant Revolt in 1381, and did not survive this insurrection.

Wage and price controls were invoked in Spain in the Sixteenth Century to curb inflation but if they succeeded in achieving anything, it was probably only to reinforce the other economic factors in the Iberian Peninsula which started the economic decline lasting until the middle of the Twentieth Century. However, it is, perhaps, rather more appropriate that an examination of the "evolution" of an incomes policy in the United Kingdom should start from 1939 with the outbreak of the Second World War.

The British Government in 1939 was fully aware that a major war would create very serious inflationary trends in the country. The Government had been giving a lot of attention at the time as to what controls should be imposed on wages and prices if and when War broke out./...

(1) JOHN. B. WOOD. op cit. p. 159.

out. In particular, it was also highly concerned as to how labour could be directed to those industries and jobs that were of prime importance to the war effort.

At the outbreak of war in September, there was a Conservative administration in power, which did not have the support of the labour unions. They were deeply suspicious of it. This lack of trust and confidence did not provide a helpful background against which the extremely urgent and important issues had to be decided. Although late in 1939 and at the beginning of 1940 the Government urged both sides of industry not to press for higher wages or to raise prices, it did not, initially, have very specific proposals to make despite the setting up of a National Joint Advisory Council composed of employers and unions as well as members of the Government.

In November 1939, Keynes (2) published his proposals on how the problem of inflation might be dealt with. The Government as well as Keynes appreciated that the very rapid and extensive increase in Government expenditure would greatly increase incomes in many sectors of the economy. If there were insufficient consumer goods available to satisfy the increased demand flowing from the rise in wages, prices would rise at a fast rate. As the War proceeded in the early months of 1940 and the military situation grew more critical it was realised that drastic steps would have to be taken without further procrastination. Initially the Government, as a temporary measure, decided to forestall price increases by providing food subsidies in order to keep the cost of living down, but this in itself was not a solution as

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(2) J.M. KEYNES: "The Times". 14th and 15th November, 1939. He observed, that "...those whose first thoughts run to rationing and anti-profiteering have not begun to discern the real nature of the problem - namely that the aggregate purchasing power is increasing faster than the available supply of goods".

it did not provide any answer to the rapid rise of incomes. By itself it would serve only to aggravate the problem.

Keynes's famous pamphlet "How to Pay for the War" was an acute analysis of the inflationary problem and contained a profound understanding of the economic issues at stake. His solution, although in some respects, perhaps, too sophisticated to expect to win acceptance in full by either the private sector or by the Government, was nevertheless a basis on which the system of controls, subsidies, savings and taxation could be built. While approving of the provision of subsidies, he suggested that incomes could be held in check by the institution of a system not only of encouraging voluntary saving but also of compulsory saving by what was, in fact, a deferred income scheme, not unlike a loan levy which post-war budgetary policies in some countries have incorporated. At the same time, Keynes sought to promote the acceptance of his scheme by the unions, who were unequivocally hostile to any government intervention in the collective bargaining system, by ensuring that there would be a higher national minimum wage and that price controls and rationing would ensure that there were sufficient essential consumer goods for all income levels. This would mean that the standard of living would not be unfairly distorted in favour of higher income groups in the economy.

The unions, however, were still unenthusiastic about these proposals and the more conservative members of the civil service, especially the Treasury, were not prepared to accept some of Keynes more "radical" suggestions such as a "post-war" capital levy. However, the deferred income scheme was "converted into a system of post-war credits based on the amount of income tax paid".(3)

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(3) B.C. ROBERTS: "National Wages Policy in War and Peace". p. 29.

The resignation of Mr. Chamberlain and the appointment of Mr. Churchill as Prime Minister in 1940, the deteriorating military position, and the inclusion in the Cabinet of prominent members of the Labour Party, such as Mr. Ernest Bevin, a former union leader, resulted in further action being taken. A National Arbitration Tribunal was set up to decide disputes between labour and employers which were not settled by negotiation. Its decisions were legally binding. In addition, an Order in Council gave the Government power to prohibit strikes and lockouts. It is, however, essential to bear in mind that direct State intervention in the determination of wages was applicable only where there was a dispute not susceptable to settlement by the parties themselves. This intervention was required to prevent possible serious industrial unrest and disturbance causing damaging delays in production. The Government appears, at first, to have made some indirect attempt to steer the decisions of the National Arbitration Tribunal along the road it wanted but the Trades Union Congress soon made it clear that it would not tolerate or submit to any such government influence or direction of the Tribunal. Indeed, the Government did not try to follow through with any other direct intervention in the control of wages in view of the attitude taken by organised labour. As a result of labour's stance and the decision by the Government not to pursue direct intervention further, it is, perhaps, somewhat surprising that inflation, though serious, was not as great as might, in these circumstances, have been expected. B.C. Roberts [4] observed that "the policy of stablisation based on subsidies and price controls was continued and, in conjunction with rationing, high levels of taxation and the willingness of employers, unions and general public to behave with

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(4) B.C.ROBERTS: op cit. p. 32.

restraint and responsibility, the Government managed to keep the economy remarkably steady". The public realisation of the national emergency and the very real feeling of patriotism and need for self-sacrifice were without doubt significant contributory reasons why the somewhat unscientific and makeshift policies were as successful as they proved to be. Indeed, when the immediate post-war period in the Netherlands is examined later, it will be seen that public acceptance of the need for restraint and co-operation was partly instrumental in making the Dutch incomes policy a workable and valuable instrument in promoting economic recovery in the latter half of the 1940's, and the early years of the following decade.

Despite the economic weapons used to prevent price and wage increases these did, nevertheless, occur as the table below illustrates.(5)

		Wage Rates	Earnings	Retail Prices.
1938	Oct	100	100	100
1940	July	110	130	119
1942	July	124	143	130
1945	July	143	180	148

Besides high rates of taxation, there was at the same time a very considerable amount of voluntary saving. In 1938 and 1939 the annual sum of small personal savings was £57 million and £103 million respectively, while in 1944 and 1945 the annual sum had risen to £716 million and £676 million.

As far as the direction of labour into the most important industries was concerned, War industries did tend to offer relatively higher wages and earnings were naturally higher in view of the overtime worked.

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(5) Source: "LONDON AND CAMBRIDGE ECONOMIC BULLETIN"

The Government did have power to compel people to go to specific industries but probably this aspect in itself was not a major factor in the allocation of labour, although these powers for the direction of labour were very wide. Patriotism, as already indicated, was an added factor encouraging labour to move to where it was most needed. Significantly, there was also a narrowing of wage differentials as craftsmen's wages did not rise at the same rate as other wages. The reasons for this narrowing of differentials during the War may be attributed to a variety of factors such as the change in the type of goods made, the methods of production and the strength of the "general" unions as distinct from the craft unions.

By the time the war ended, although prices and wages had risen very steeply, the battery of economic instruments used to control them had not been ineffective and the average annual increase in the retail price index of about 7 per cent was, in the circumstances and in view of the relatively limited intervention by the State in the determination of wages, suprisingly low.

In 1945, at the end of the hostilities, a quite different set of problems arose. There was now the need to adjust the economy to peacetime conditions. Relations between the new Labour Government and the unions were relatively amicable.(6) Allan Flanders notes that "the Government, for its part, anxiously sought their collaboration at every turn both in developing its new economic and welfare policies and in trying to master the country's acute difficulties of transition and readjustment. Apart from union representation on innumerable committees and councils, trade union leaders had access to Labour Ministers with whom they could talk on terms of easy familiarity." Realising the continuing danger of inflation the Trades Union

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(6) ALLAN FLANDERS: "Trade Unions" 7th (revised) Ed. 1968 p.166

Congress accepted a continuation of the war-time regulations which provided for price controls, rationing, arbitration and the prohibition of strikes and lockouts. Nevertheless the element of self-sacrifice, as the country was no longer at war, and the willingness to accept severe austerity measures, were much less compelling. Some steps were taken in 1947 by the Government, whereby the Control of Engagements Order in that year provided that people must seek employment through the labour exchanges and could be directed to essential jobs but this measure, accompanied by Government exhortation, discussion within industry and between government and industry was not successful in securing any really effective control of wage rises.

In February 1948, as a result of a steadily deteriorating economic position the Government issued the famous White Paper on "Personal Incomes, Costs and Prices".(7) This was a major statement of policy which was described in 1951 by one economist as "the one outstanding example of an attempt by the State to influence wages policy"(8) in the United Kingdom. The statement enunciated the principle that "there should be no further increase in the level of personal incomes without at least a corresponding increase in the volume of production".(9)

Despite this statement the Government in the White Paper agreed not to control directly the incomes of individuals except through fiscal measures. In an effort, however, to persuade industry to adopt greater restraint, the Government warned employers that it would not necessarily take into account wage increases in permitting increases in the prices of those goods still subject to price control. In addition

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(7) Cmnd 7321 H.M.S.O. 1948

(8) C.W. GUILLEBAND: "Wage Determination and Wage Policy" p. 20

(9) Cmnd 7321 op cit.

the White Paper accepted that "increases in wages and salaries would be justified from a national point of view ..... where it is essential in the national interest to man up a particular under-manned industry and it is clear that only an increase in wages will attract the necessary labour".

Notwithstanding the control of prices which had been carried over from the war-time regulations, the unions objected that there was no direct control of profits or of dividends and that those who received incomes in this form were favoured at the expense of the wage earner.[(10)] However, the Trades Union Congress finally accepted the basic principles set out in the White Paper. The critical state of the economy was probably a major reason for its acceptance of this statement of Government policy. During the ensuing period of nearly two years and despite the lack of compulsory controls over wage determination a remarkable degree of restraint was observed. To a limited extent the rate of inflation was checked but wages rates and earnings continued to rise and consumer demand naturally increased, although the high level of taxation did help to modify this demand. Unfortunately the monetary policy of the Labour Government did not assist in encouraging a reduction in the rate of increase in money incomes as the money supply was not sufficiently restricted, interest rates remained relatively low and furthermore the Government did not reduce its own borrowing and expenditure. The devaluation of the pound sterling in 1949 and the rise in import prices resulting from this action together with the rise in import prices of some primary commodities caused by the Korean War, made substantial price rises in Great Britain unavoidable. The unions

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(10) This objection could be met, in part, by taxing "unearned income" at a higher rate than "earned income".

were becoming more and more hostile towards wage restraint and it became clear that the wage policy enunciated in the White Paper in 1948 was collapsing. In 1951 wages per unit of output as well as dividends increased considerably. The type of voluntary wage policy pursued by the post-war Government was capable of success only in so far as it could pursuade both sides of industry to accept the restraint which the Government maintained was essential for economic recovery. As the cost of living rose, partly through circumstances which were beyond the control of the Government, such as the Korean War, and partly through the relatively unskillful management of the monetary policy, it was not difficult for economists to predict that the voluntary policy would fail, as indeed it did, by 1950. The Government was not prepared to adopt a really deflationary policy through the exercise of combined fiscal and monetary policies, sufficiently harsh to ensure that there was an appreciable reduction in the rate of inflation. Nor was the Government prepared to impose wage controls, consequently serious inflation continued in the absense of the vitally needed voluntary co-operation by both employers and employees. Looking back at this period from a distance of twenty years, it is, perhaps, hardly suprising that British industry was unable to recover the lead it had once held among the European economies and that the British rate of economic growth has been so disappointing in comparison with many of its European competitors.

Despite the change of Government in the elections in 1951, the Conservative Party, which gained power and held it until October 1964 proved to be no more able to control inflation or the rate of increase in wages than the Labour administration it had succeeded. Although the price and wage stabilisation policies of the Labour Government had,

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in the end, failed, it had enjoyed during most of its period of office a degree of trust from the unions that was denied the Conservatives for much of the following period.

The new administration intended to rely on fiscal and monetary policies to secure stabilisation rather than on the war-time price controls - which were already being dismantled - or on wage controls or even compulsory arbitration. Notwithstanding the good intentions of the Government and despite a clear understanding of the implications of secular inflation, especially its adverse effects on the balance of payments, the Administration did not follow through its policies with sufficient persistence and energy. The result was that there followed a long period during which the economy experienced the "stop-go" policy of boom, disinflation, mild recession and subsequent re-inflation. It was punctuated by the increasingly familiar balance of payments problems which made the disinflationary measures necessary but without achieving any long-term stabilisation. Rather there were a few fairly short-lived periods when the rate of inflation declined. The Government made a serious attempt to break out of the "stop-go" cycle in 1963 and 1964 with a policy that became known as the "Maudling Experiment", but the General Election in October 1964 and the measures taken soon after by the new Administration made it impossible to decide whether the "experiment" would have been successful.

In the later years of the Conservative Administration, from about 1956 the Government did try to evolve some coherent and acceptable policy in regard to wage increases. The attempts were to have little or no effect, except possibly in the very short-term. Meanwhile organised labour became increasingly hostile towards the Conservatives which made an effective wage policy much more difficult to apply even if it had been unequivocally stated.

Mr. Selwyn Lloyd/..

Mr. Selwyn Lloyd, while Chancellor of the Exchequer, in 1961 enunciated a "pay pause" in the public sector where the Government had some control over wages in its capacity as an employer of labour. It urged the private sector to follow its example but, as indicated earlier, this attempt was a failure as the private sector would not accept the Government's exhortations to observe greater restraint.

In the previous decade, in March 1956, to which period we must briefly return, a White Paper entitled, "Economic Implications of Full Employment" (11) was published, but notwithstanding the spelling out of what these implications were it had no effect whatever on the behaviour of industry. A Council of Prices, Productivity and Incomes was set up in 1957 and was composed of "three wise men" (12). The terms of reference were: "to keep under review changes in prices, productivity .... and the level of incomes ..... and to report thereon from time to time". It was intended to be an authorative and impartial body but was boycotted by the Trades Union Congress which refused to give evidence before it. The Council issued four Reports and then disappeared from the scene. The Government had antagonised the unions by the appointment of the Council. It was now less likely than ever that voluntary restraint would be accepted by organised labour. The next move by the Government was to try and establish a "Guiding Light" with the publication of a White Paper (13) in 1962. This policy set out a norm of 2 to 2½ per cent as a maximum for wage increases and, as indicated earlier by the observation of Wood, was a conspicuous failure.

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(11) Cmnd 9725, 1956

(12) The first were LORD COHEN, SIR HAROLD HEWETT and SIR DENNIS ROBERTSON.

(13) "INCOMES POLICY: THE NEXT STEP". (Cmnd 1622)

The Government did, however, succeed in getting the co-operation of organised labour, subject to reservations, for the establishment of the National Economic Development Council. Employer organisations also agreed to representation on this body so that both sides of industry as well as the Government were represented. It first met in March, 1962 and its intention was, broadly speaking, to examine economic aspects of the private and public sector in order "to increase the rate of sound growth". However, it had no power to compel anyone to carry out its recommendations. Although it was and, no doubt, still is, a useful forum for the discussion of economic issues and problems by the three interested parties it has "no teeth".(14) In addition, what have come to be called "Little Neddies", have been established for specific industries in order to encourage discussion and examination of problems in particular sectors of the economy.

The Conservative Government's final attempt at fostering some kind of effective policy for incomes or, at least wages, was the establishment of the National Incomes Commission in November 1962. This body, however, was largely, if not entirely, ineffective as organised labour refused adamantly to have anything to do with it. In February 1963 the Commission announced that it intended to revive the norms contained in the "Guiding Light" policy. However, the announcement was soon superceded by the Government because as Wood(15) points out "only six weeks later the Chancellor of the Exchequer unhelpfully put forward a different target of 3 to 3½% on the assumption that the economy would grow/....

(14) "The Economist" in its issue dated May 23, 1970 (p.64) thought that "the Ned organisation .... is not much more than a talking shop, but it is still a place where government and both sides of industry can meet for discussion, without necessarily taking sides and there are all too few of these".

(15) JOHN B. WOOD: op. cit. p.160.

grow by 4%. Once again", adds Wood, "salaries and wages rose more and output less than expected". Indeed, when the General Election in October 1964 returned the Labour Party to power the incoming administration was no better equipped to institute an effective incomes policy than its predecessor had been more than twelve years earlier. The same problems remained unsolved, namely, how to achieve a more rapid rate of economic growth, a high level of employment, a satisfactory state in its balance of payments together with a less economically damaging rate of inflation.

In the next Chapter we shall consider the events that led up to the first direct - and for a short period, effective - intervention by the Government in the determination of incomes in peacetime conditions in order to secure some control over the rate of inflation.

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CHAPTER V.

Although the National Incomes Commission had no authority to take effective action in the determination of any types of incomes, and although the Government had taken no such power, the Commission's reports were, nevertheless, of some value in so far as they examined wage bargains in retrospect and commented upon wage policy. Such comment was often sound. Significantly, the Commission expressed the view that an exceptional increase in wages was not justified solely on the grounds that it was difficult to obtain sufficient labour for a particular job; "the manpower needs of an industry had themselves to be 'exceptional' to justify exceptional treatment". The Commission's attitude appeared to show some sympathy for the views expressed by W.B. Reddaway and other economists, already mentioned, whose investigations had led them to doubt whether direct attempts to change relatively long-standing wage differentials to encourage the movement of labour had been particularly successful in achieving their purpose. The institutional background in any country and particularly the United Kingdom, seemed to indicate that it was very difficult to achieve, let alone maintain, significant changes in differentials except in exceptional circumstances unless these changes were already in process, in which case the action by the State might be able to retard them or hasten them to a very limited extent.[1] B.C. Roberts is surely right when he observes that "the narrowing of differentials between the wages of skilled and unskilled workers, between manual and clerical workers, and between men and women workers, as well as the levelling up of wages of one industry compared with another, is not a course of development that is confined to countries that have pursued national wage policies. It is

a feature/...

(1) B.C. ROBERTS, op cit 85-87

a feature of industrial and social progress almost everywhere". Nevertheless the narrowing of differentials may proceed at different rates in different sectors or industries or categories of jobs, depending on a variety of factors. Roberts, however, remarks that "there would seem to be limits, which are set by economic and social circumstances, to the extent to which it is possible to force wage structures into a particular mould ...... It is admitted by trade union supporters that the slowing down of the narrowing trend, and in certain cases its reversal, is due to economic factors, and in some degree, to a change in trade union and employer policy, brought about by a growing resistance on the part of the higher paid wage and salary workers to further levelling".

The National Incomes Commission disappeared with the advent of the Labour Government to power in 1964. Nevertheless the establishment of the Commission, its Reports and especially the attitudes adopted towards it both by the Government instituting it, and by both sides of industry are important and enlightening in tracing, however briefly, the development of incomes policies in Britain in relation to their attempt to control inflation.

In October, 1964, when the Labour Party was returned to power, it was immediately confronted with a major economic crisis caused by the critical situation of the country's balance of payments. However, the Parliamentary majority of the Government was very small, and this may well have been, at least partly, the reason for its failure to take more effective economic action at an earlier stage. The Government did consider the possibility of devaluation but decided against this measure. Moreover it is clear that the Government was fully aware, not only of

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the economic situation but also of the lack of confidence felt by authorities in other countries of the new Government's ability to cope successfully with the crisis. As the Government relied to a great extent on the support of the unions, it was naturally most reluctant to interfere directly in the wage determination process. Meanwhile money incomes continued to rise at a fast rate and unemployment remained at a low level of about 1.5 per cent. Moreover unfilled vacancies rose from 313,200 in 1964 to 354,000 in 1965 indicating as C.W. Guillebaud observed "indisputable symptoms of an over-loaded economy with over-full employment".(2) In addition the large deficit persisted in the balance of payments.

Shortly after taking over the administration of the country, the Labour Government did succeed, however, in Decemmber 1964, in obtaining the signatures of both sides of industry to a "Declaration of Intent" in which the Government and both the employers' organisations and the Trades Union Congress declared that they "must take urgent and vigorous action to increase productivity, keep money incomes in line with real output and maintain a stable price level otherwise the level of employment would be lower and the rate of growth slower". The Declaration was unexceptionable but it seemed to optimists at the time to herald some new, but unspecified, era of co-operation. The Declaration, indeed, did not appear to have any material effect in slowing up the rate of increase in prices and wages or upon the actual behaviour or attitudes of industry in general, despite agreement with the Government to the setting up of suitable machinery to review the price movements and increases in money wages. It was hardly surprising. The Declaration did not legally commit anybody to anything.

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(2) C.W. GUILLEBAUD: op.cit. p. 34.

The "machinery" mentioned in the previous paragraph included the establishment of the National Board for Prices and Incomes in April 1965. This was constituted by Royal Warrant. Its scope and manner of operation were set out in two White Papers,(3) in February and April of that year. The influence of the Board on prices and incomes in the first year of its operation was probably minimal as it had no power to compel anyone to act in accordance with its views or recommendations. Industry could and did ignore it. Indeed its relatively rapid establishment in 1965 was probably made possible only because it had been given "no teeth". There was, therefore, no really cogent reason why industry should be opposed to its formation which flowed from the somewhat pious hopes behind the "Declaration of Intent" signed at the end of the previous year.

As prices and wages moved inexorably upwards during the latter half of 1965 and no restraint was observable in industrial negotiations, the Government decided to introduce what was termed an "Early Warning System"(4) requiring notification of wage and price increases. But once again there was no provision compelling the deferment of proposed increases until after the Prices and Incomes Board had considered the issues involved, so this type of "early warning" did not make the government's voluntary incomes policy any more effective. The policy was still to be voluntary and industry in general did not appear to be any more willing in practice to take heed of it although the White Paper stated that "the parties will be expected to suspend further action until the Board has reported". Even while the provisions of the White Paper were still before Parliament the economic crisis which occurred in July 1966 made/...

(3) "Machinery of Prices and Incomes Policy" - Cmnd 2577
"Prices and Incomes Policy" Cmnd 2639

(4) "Prices and Incomes Policy: An 'Early Warning System'" Cmnd 2808

1966 made drastic action by the Government unavoidable. Voluntary policies were now recognised to be quite inadequate to cope with the situation and crisis of confidence in the British economy which came to a head in the middle of the year.

The central problem of the type of incomes policy which had been evolved up to the middle of 1966 was not that it failed to recognise the importance of the relationships between prices, wages and output in the existing inflationary situation. The trouble was that there was no readiness on either side of industry to take the type of voluntary action through co-operation which would render the policy at least to some extent effective. The White Paper in April, 1965, referred, sensibly enough to trends in national productivity and remarked that "the figure for the growth of the economy between 1964 and 1970 which is being assumed in the preparation of the Government plan for economic development is 25 per cent," giving "an annual average rate of growth of rather less that 4 per cent". After making various assumptions the White Paper spoke of "an average annual rate of growth per head in the nineteen fifties (which) averaged about 2 per cent a year". In addition, the White Paper set out the criteria, in admittedly fairly general terms, which would, it felt, justify price and income increases and which would control inflation and encourage growth. But it was unsuccessful in its attempt to obtain an effective response from independant decision-making bodies. The voluntary system of restraint in the first half of the decade beginning in 1960 had been proved beyond a doubt to have been a failure in the United Kingdom in peacetime conditions prevailing at that time irrespective of the seriousness of the economic situation. The

exhortations/....

The exhortations that appeared to have had some beneficial effect in the immediate post-war period between 1945 and 1950 and especially in 1948 and 1949, did not seem to have any significant success in the succeeding decades. In the circumstances, the economic crisis of 1966 was, perhaps, inevitable, and the mandatory powers that the Government was then obliged to take over prices and incomes, probably unavoidable.

The abandonment of the policy of voluntary restraint was followed by a "standstill" period of six months, which was itself to be succeeded by a similar period of "severe restraint". The policy of the Government was set out in a White Paper in July.(5) The "standstill" meant what it implied. Prices and incomes would not be increased for six months. Legislation was introduced immediately to give effect to this decision and the Prices and Incomes Act became law in the following month. The Government made no secret of the urgency of the policy and the need for immediate action. The Act was in four Parts. The first part established the Prices and Incomes Board as a permanent statutory body - no longer deriving its existence from the Royal Warrant - and the Minister of Economic Affairs, then Mr. George Brown, was empowered to refer to it proposed increases in prices, wages and dividends. Part II was intended to give legal effect to the "Early Warning System" which had been before Parliament when the crisis came. Any wage agreement or any proposed claim was to be referred to the Minister within seven days to decide whether or not to refer it to the Prices and Incomes Board. If he decided to do so the award was not to be implemented until after the Board had considered the claim and had reported on it. Any implementation of an agreement prior to the decision of the Board would render the parties concerned liable to prosecution. This section of the Act, however, did not prevent increases

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(5) Cmnd 3073 (July 1966).

either in prices or in awards after the Board had reported even if the Board did not consider the increase justified. Accordingly, Part II was a delaying procedure and not an indefinite prohibition on increases in prices, wages and dividends. Moreover, Part II required an Order in Council to bring it into operation and this Order would have a duration of twelve months only. It could, however, be renewed. Part III of the Act is not really material to the present discussion of the development of the United Kingdom's incomes policy. Part IV, however, empowered the Minister to make Orders which prohibited increases in prices and wages and in the distribution of company profits. An infringement of an Order rendered the party liable to prosecution.

The Government in trying to make the Act less unpalatable to the public in general and organised labour in particular attempted to obtain the co-operation of industry so that the "standstill" would at least be made to appear as if it were voluntarily observed. This so-called "voluntary"co-operation would then make the Government's direct in-cursion into wage and price determination appear to be less mandatory that, in fact, it was. However, on a few occasions the powers provided for in the fourth part of the Act had to be invoked, in particular in November 1966. It is, therefore, inaccurate to claim that the incomes policy was voluntary because the Government did not in practice often have to use its powers. These powers did exist and were seen to be used when necessary. Such a policy is no longer "voluntary".

During the "standstill" period prices did, of course, rise. This was both permissible and indeed unavoidable where the cost of imported raw materials and components increased or where increased taxation or "changes in supply due to seasonal or other reasons"[6] made price increases/....

(6) Cmnd. 3150 (Novermber 1966) and Cmnd. 3073 op cit.

increases virtually uncontrollable. For example, electricity charges were raised during the "standstill" period. Nevertheless the six month compulsory "standstill" did, undoubtedly, significantly affect prices and wages in that inflation was virtually brought to a halt. The Government had been at pains to emphasise that it's intention was that both the "standstill" and the ensuing period of "severe restraint" were to be essentially short-term measures.

In November 1966, the Government published a further White Paper dealing with the period of "severe restraint". There was to be a norm which was stated to be zero. This norm however, was subject to exceptions in the case of certain workers in the lowest paid categories of jobs. Exceptions were also to be permitted in the sphere of agreements where there was improved productivity. This exception in the case of an improvement in productivity was intended to promote increased industrial efficiency so that there was to be an incentive for management and workers to work out agreements which would result in a more efficient use of the resources of the country. The famous remarks of the celebrated American management consultant Mr. W.W. Allen in 1964 had received great publicity at the time and had not been forgotten.

In March 1964, Mr. Allen had published an article in the British newspaper, "The Sunday Times"[7], and had asked the question "Is Britain a half-time country, getting half-pay for half-work under half-hearted management?" Mr. Allen claimed that "for every person required to produce a ton of steel in America, three were required in Britain. By a similar method of comparison, the ratio in aluminium is one to two point five. In the maintenance engineering activities of

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(7) "The Sunday Times" - 1st March, 1964

the two chemical industries, the ratio is about one to four". Mr Allen claimed that in each of these examples the technologies employed by the industries of each country were at approximately the same levels. Mr. Allen, moreover, claimed that " in shipbuilding .... ships could be constructed with about 40 per cent fewer men if labour were employed efficiently. This could be achieved ..... simply by removing the more irrational and non-logical forms of demarcation practised by labour and management alike".

Mr. Allen had earlier pioneered the famous Fawley productivity agreements in Esso's British plants. His reputation accordingly gave his remarks very considerable weight. The Government, rightly, did not want productivity and its relationship to increased wages to be lightly disregarded. A genuine increase in productivity should, in the opinion of the Government, not go entirely unrewarded.

As the period of "severe restraint" drew a close a great deal of debate took place as to what policy should succeed it. Both the Trades Union Congress and the Confederation of British Industries wanted to see an end to direct government intervention but realised that this was unlikely to be forthcoming unless they provided their own effective alternative to Government intervention.

The White Paper in March 1967 (8) prefaced its proposals with the hope that an effective voluntary incomes policy could be instituted. The criteria for wage increases included:-

(a) increased productivity - with the proviso that the public should also receive a benefit in lower prices:

(b) the need to ensure a distribution of manpower where pay changes were required to obtain such a distribution:

(c) the/....

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(8) "Prices and Incomes Policy after 30th June 1967" (Cmnd 3235)

(c) the maintenance of "a reasonable standard of living" and applied to the lowest paid workers:

(d) instances where "pay of a certain group of workers had fallen seriously out of line with the level of remuneration for similar work and needs in the national interest to be improved".

These criteria were, in fact, those that had been laid down in the White Paper two years earlier, in April, 1965, when the system was intended to be a purely voluntary one. The criteria for price increases and reductions were also those contained in the same White Paper. The Government noted that its "call for a standstill on company distributions during the twelve months of standstill and severe restraint has been given full support by industry and commerce". The Government added that although the restraint would end in July 1967 "companies should exercise moderation in distribution during the following year consistently with the principles of this White Paper ...... The Government will stand ready also to refer to the National Board for Prices and Incomes ..... cases where the growth of profits and dividends is based on excessive market power".

The White paper also expressed the hope that wage negotiators "would not seek to make good increases forgone as a result of the standstill and severe restraint". This hope was not to be realised.

Although Part IV of the Act of 1966 lapsed the Government decided to retain its delaying powers provided for in Part II so as to be able to refer, when it thought necessary, price and wage increases to the Board. This period of delay would not exceed seven months - including one month in order to decide whether to refer the increase to the Prices and Incomes Board and a period of three months for the

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Board to investigate the matter and make its recommendations. Its recommendations did not, however, have the force of the law but the Government could delay the increase for a further three months if it wished.

Despite the goods intentions of the Confederation of British Industries and the Trades Union Congress and their awareness that if the voluntary system again failed to work, direct Government controls might be reimposed, the period following the "severe restraint" saw a resumption of rapidly rising prices and wages which to a large extent proceeded to undo the success of the previous year's policy to reduce the rate of inflation. In the twelve months from July 1967 and July 1968 aggregate incomes rose by approximately 7 per cent as compared with about 2 per cent in the previous year making an average of $4\frac{1}{2}$ per cent over the two years. The mandatory control over wage increases in 1966 and the first half of 1967 did not succeed in having a lasting effect.

What then was the principal difference between the phase after July 1967 as compared with the period up to July 1966? The Prices and Incomes Board in its Second General Report (9) stated that "the outstanding difference between the older criteria and the newer is that under the newer criteria the norm is nil whereas under the older criteria exceptions from a standard wage increase or 'norm' of $3-3\frac{1}{2}$ per cent could be allowed."

We indicated that the hopes of the Government were not realised by the new policy but its predecessor did, nevertheless, have certain short-term effects which were not insignificant. In the previous year from July 1966 to July 1967 the Board calculated that although "total industrial production fell .... by about 1 per cent ...... industrial production expressed in terms of output per person rose about $2\frac{1}{2}$ per cent". The Board added that "the difference between the fall in total industrial production and the increase in output per man was due/....

(9) "Second General Report": July 1966 to August 1967 Report No. 40 p.2. Cmnd. 3394.

due to an increase in unemployment from under 300,000 in June, 1966, to roughly 500,000 in June 1967 .... The increase of about 2 per cent in average earnings as against the increase in output per head of $2\frac{1}{2}$ per cent meant, "continued the Boards Report, "stability in unit labour costs through the entire twelve months, and in fact, a fall up to the first quarter of 1967. This stability compares with the increase in unit labour costs in manufacturing industries of 6 per cent between 1964 and 1965 .... and with an average annual rise of $2\frac{1}{2}$ per cent in such costs in the past 10 years". Lastly, and perhaps, to a large extent the central objective of the whole incomes policy was that from July 1966 to May 1967 export prices in the United Kingdom "rose by less that 1 per cent".(10)

The economy of the country was, however, a long way from being free from very serious difficulties. As a result of escalating wages and prices in the latter half of 1967, persistent widespread lack of confidence in the economic situation, a deterioration of the balance of payment and yet another sterling crisis, the Government finally devalued the pound by 14.3. per cent in November 1967. It was a step that many British and overseas economists thought long overdue. The pound, many claimed, had been unmistakably over-valued.

The Government did not take any immediate drastic steps to curb demand in the home market concluding that there was a measure of slack in the economy which could absorb any immediate switch from foreign to domestic goods. The budget in March 1968, was, as might have been expected extremely severe. There was, however, no return to direct intervention in the determination of wages and prices

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(10) "Second General Report" op cit, pp 4-5

except that the Government extended in August 1968, its delaying powers from 7 months to 12 months and decided that these powers would be effective until the end of the following year.

Prior to the period of the "freeze" the unions has tried to deal with wage claims themselves. The Trades Union Congress attempted towards the end of 1965 to exercise greater control over organised labour by vetting claims for increases through its Incomes Policy Committee. It continued this policy after the period of "severe restraint" terminated in July 1966. These efforts were to have little effect on the behaviour of the unions. This was mainly because when a claim was rejected by the Committee the union could ignore the decision. Although between May 1967 and May 1968 of the 441 claims considered only 126 were approved as they stood this was not in itself very meaningful. The Committee was dealing with claims and the settlement eventually reached by the Union and the employers might merely have established what the union had thought acceptable initially but had raised its sights for purely tactial reasons when bargaining commenced. If the Committee rejected a claim as being excessive its rejection would probably provide no more than an argument for the employers' representative at the negotiating table.

Of rather more significance were the criteria on which claims were to be approved. The Trades Union Congress considered that output could increase by 6 per cent productivity by 5 per cent and employment by 1 per cent so that wages could increase by 5 per cent without causing inflation. This was certainly a far more optimistic forecast and assessment than the Government thought feasible at the time and the Government's view was borne out by subsequent events. Thus not only did the Trades Union Congress not have mandatory control over

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its members but even if it had, its criteria were inappropriate for the prevailing economic conditions. It was therefore not surprising that a much stronger policy for control over wage claims was necessary.

The White Paper (11) issued in April, 1968 shortly after the Budget was announced re-introduced the criteria for increases in earnings of up to $3\frac{1}{2}$ per cent which had prevailed in 1965 and the first half of 1966. The criteria were subject this time to two exceptions where the ceiling might be raised about this figure, namely "where there is a marked contribution to increased output per man hour, or a major revision in the pay structure". The Prices and Incomes Board later remarked that "this second exception would seem to be an outcome of some of our individual reports" (12). It was not unfair or immodest of the Board to suggest that its reports had influenced Government policy. They had. They also had some influence on the behaviour and the decisions within industry.

The delaying powers of the Government in respect of wages and prices could also be applied to dividend distributions. Rents were then and for a long time previously subject to widespread control through separate legislation. Increases in the incomes of self-employed people could not, of course, really be effectively restrained by the incomes policies of the Government except through indirect methods of price control or through fiscal measures. This had always been a problem but not sufficient to defeat the effectiveness of a thoroughgoing "freeze" and "squeeze" as had operated in Great Britain in 1966 and 1967.

The White Paper in April, 1968, as distinct from the one issued a year ealier, accordingly permitted a maximum of $3\frac{1}{2}$ per cent increase in earnings. Unfortunately it soon emerged in negotiations that the unions

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(11) "Productivity, Prices and Incomes Policy in 1968 and 1969" (Cmnd 3590)

(12) "Third General Report" August 1967 to July 1968 Report No. 77 (Cmnd.. 3715)

regarded this percentage as a minimum rather than as a maximum and bargaining was generally conducted under this unwarranted assumption. The Government apparently had not anticipated that there would be strong pressure for increases above the enunciated amount and found it very difficult in practise to take a strong line against organised labour despite the delaying powers which it had retained. The unpopularity of the Government at this time, the growing number of strikes and industrial stoppages which threatened to undo the short-term benefits of the devaluation of sterling in respect of exports, made the Labour Government less resolute in ensuring that the level of wages did not rise above those criteria laid down in the prevailing White Paper. The hostile political climate in the country, especially from among its own supporters within the union movement, was not conducive to the Government adhering strictly to its own incomes policy. Perhaps the most significant event which made the unions, employers, and indeed the public in general, regarded the Government's lack of determination to implement its own policy, as a signal for them to disregard it too, was the Government's "capitulation" in July 1968 to the unions in one of the nationalised industries - British Rail. Despite the reasons given by the Government for agreeing to the Railway Board's offer of 3 per cent "on account" which was "to be absorbed in payments linked with working changes still to be settled by the target date of 2nd September set by the parties",[13] it was, in effect a "capitulation" to the unions following a "go-slow" strike in June and July of that year. The all-important issue at stake was that the 3 per cent was not seen to be given for immdiate and definite increased productivity. When the private sector saw that the Government had itself failed to adhere to its own policy, there was little further incentive for the private sector to observe restraint. And indeed this, in effect, is what happened. If any one action can be singled out as the main/....

(13) National Board for Prices and Incomes "Third General Report" Part II p. 23.

main cause of the succeeding disintegration and collapse of the incomes policy as envisaged by the Government early in 1968, it was its own behaviour when threatened by serious disruption by labour in a nationalised industry. Had the Government held firm and declined any increase not patently justifiable in terms of its own criteria for increases, there would have been a much greater liklihood of the incomes policy having been materially helpful to the economy during the following year and a half. It might in any event have failed for other reasons, but its fate was probably decided in July in Penzance where the railway negotiations took place. The Government did not provide the exampl e essential for the success of the policy in a political and social climate extremely hostile to wage restraint.

It was stated in the Introduction that it was important to consider whether the lack of success of an incomes policy was a result of a lack of determination by a government in implementing the criteria for increases in wages and other incomes. The negotiations at Penzance and the "capitulation" must surely provide a forceful argument for those who claim that the policy failed, at least in part, because of lack of resolution by the Government. "The Economist"(14) at the time remarked that "British Rail's familiar surrender to the railway unions last weekend came after two weeks during which this nationalised industry in large deficit had intoned that it would in no circumstances give an across-the-board wage increase to its workers until it got a copper-bottomed (a Wilsonian adjective) productivity agreement; and during which ministerial spokesman had said that the Government would enforce the incomes policy, but otherwise would not interfere. It is now apparent" continued "The Economist", "that both British Rail and ministers were making promises/....

(14) "The Economist". 13th July, 1968 pp 14 -15. The words in parenthesis appear in the article.

promises that they had not got the resolution to keep". The journal added in the same article that "last weekend thus spread the impression to the world that the Government does not believe its own incomes policy (or, as far as Mrs. Castle and Mr. Marsh are concerned,(15) apparently even understand what it is). That was the wreck of Penzance."

Negotiations were continued during August at Windsor and an agreement between British Rail and the unions was reached providing for increased productivity in return for increased wages. The comments of "The Economist"(16) are again, worth noting. "The bad half of the egg" contended the journal "is that it is once again proposed that this increased productivity should be paid for before it is achieved". The cost of the wage concessions was estimated at £13 million a year and British Rail considered that the improvements in productivity should bring an ultimate saving at an annual rate of £13.3 million. "The trouble is", observed "the Economist", "that the increases are due to start on September 2nd. The 'target date' for achieving the full annual rate of savings is said to be early in 1970 .... Even on British Rail's own accounting the full saving after 1970 will be only £0.3 million a year more than the present pay-out; it could take the railway up to 40 years to recoup the pre-productivity £13 million or so that may have been paid out in the meanwhile."

It is not without interest to study the summaries of the Reports by the Prices and Incomes Board after July 1967 in respect of prices and wages in particular industries. Their report in November 1968 on "Pay and conditions in the Construction Industry other than Building and Engineering"(17) observed that "in Government departments, however, there/.....

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(15) MRS CASTLE and MR. MARSH were, respectively, the Minister of Employment and Productivity and the Minister of Transport.

(16) "THE ECONOMIST". 17th August, 1968 p. 52.

(17) Report No. 93 (Cmnd 3838 - November, 1968.)

there had recently been an across-the-board pay increase of $3\frac{1}{2}$ per cent for all industrial employees including the building workers. This settlement did not seem to us to be related either to productivity or to the specific needs and requirements of individual groups of workers".

In February 1969 the Board reported on the pay in the London Clearing Banks.(18) It later remarked that the decision of the Federation of Bank Employers to pay in full with retrospective effect from 1st July 1968, the increases contained in the agreement which had been referred to the Board, did "not meet the requirements of the Government's incomes policy". It will be recalled that the powers which the State had retained since July 1967 were of a delaying nature only so that agreements could be given effect after the expiry of the period of delay.

In March 1969 the Board found itself unable to approve the increase permitted by the Department of Employment and Productivity in September of the previous year in respect of pay and conditions in the electrical contracting industry in Scotland.(19) However, it accepted that the $3\frac{1}{2}$ per cent average increase should be allowed to stand although a subsequent agreement in December which the Board had been asked to examine and whose decision was unfavourable was not implemented.

It is not, perhaps, unfair to suggest that the Government torpedoed its own policy through its lack of resolution, but it must be pointed out at the same time that some of the Board's recommendations which did not approve increases agreed upon were, indeed, supported by the Government and "standstill" orders were made in terms of the delaying powers. In some cases, such as that of the Clearing Banks, already/...

(18) Report No. 106 (Cmnd 3943 - February 1969)

(19) Report No. 108 (Cmnd 3966 - March 1969)

already mentioned, industry indicated that the agreed rates would be paid upon the termination of the period of deferment notwithstanding the view of the Board.

As 1969 drew to a close the escalation in wages and to a far lesser extent in prices began to concern both the Government and, not least, the officials of the International Monetary Fund whose huge loans to the United Kingdom would still require a very substantial improvement in the country's balance of payments and in particular in "visible" and "invisible" earnings. The big improvement in the British balance of payments - especially in its increase in exports over imports in the closing months of 1969 had made the "wage explosion" appear less harmful to the economy than would have been the case if there were still a large deficit.(20) As economists were pointing out the rise in prices which had not yet been felt in the home or export market to any great extent was bound to start eroding the advantages that still remained from the devaluation of two years earlier and the monetary and fiscal policies pursued by the Government since then. Prices were merely lagging behind the rise in wages and as wage costs rose, so, in time, would prices. In the early months of 1970 there was a decline in the monthly "visible" trade figures from February. Various reasons were given for this trend which in May resulted in a visible trade deficit of £31 million, the largest deficit since the preceding July. This was followed by an even larger deficit of £51 million in June. The slowing up of international trade generally and the decline in the United States economic position which showed absolute decreases in gross national product for the last quarter of 1969 and the first quarter of 1970 were

probably/.....

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(20) In 1968 and 1969 there were respectively deficits on visible trade of £643 million and R141 million. The surplus on invisibles rose from £324 million to £557 million. The current balance for the two years showed a deficit of £319 million in 1968 and a surplus of £416 million in 1969..

were probably the principal reasons. The increased imports necessary to re-build the unduly low level of stocks and the higher prices of some primary commodities also had adverse effects on the country's trade balance.

The "wage explosion" soon began to assume very serious proportions. It was realised even more strongly that the achievements of the past years - whether or not due in part to the incomes policy - would soon disappear as a result of rising prices if effective action were not taken. The Government was well aware of the potential seriousness of the position but was equally aware that its unpopularity in the period from 1966 to 1969 was in no small measure a result of its harsh deflationary policies and its restraint on incomes. It had lost much of its traditional support from organised labour not only as a result of its direct interference in wage negotiations, but also because of its attempt in 1969 to introduce legislation to delay unofficial strikes and work stoppages in contravention of negotiated agreements. In January of that year the Government had outlined its relatively mild proposals for industrial reform. These proposals, however, had been received with hostility by the unions. (21) "The Economist" claimed that the proposals "never grasped the nettles" but added that "once a Labour government had written into the statute book the principle that certain legal action be taken to delay breach of contract strikes, the way would probably be easier for the next government to start enforcing the ordinary law of contract on trade unions - in what nearly every industrial country would regard as a normal democratic way". In the middle of 1969 the Government abandoned its attempt to place such legislation on the statute book in the face of great opposition from the unions and lack of

agreement/.....

(21) "THE ECONOMIST". 21st June, 1969.

agreement within the Cabinet itself. Accordingly, despite the remarks of the Chancellor of the Exchequer, in the Budget Speech in April 1970 that "wages cannot for long increase at the present rate" nothing was suggested or done to prevent this happening. It was generally realised and accepted that nothing would be done until after the General Election. In local elections in 1970 there had been a surprisingly and, perhaps, inexplicably, large swing to the Labour Party and the opinion polls predicted a Labour Party victory if a General Election were to be held. The Government decided in May to hold a General Election the following month although there was no necessity to dissolve Parliament until 1971 when its five year term of office would expire. Whichever party was returned to power, would clearly be faced with the difficult problem of restraining the rise in wages and also in prices, the latter now making themselves felt in the economy. But as in all real world situations, the issues were complex and the relatively high level of unemployment, although partly regional and structural, did to some extent suggest "cost-push" inflation as being, at least, a major cause of the rise in the price level.

The General Election on the 18th June returned the Conservative Party to power. In their Election Manifesto the Conservatives had stated that the incomes policy of the Labour Government would not be continued. Statements by ministers after the election indicated that this undertaking would be honoured. In August, Mr. Robert Carr, the Minister of Employment and Productivity told leaders of the Trades Union Congress that there would be "no freeze, no norms, no White Paper and no criteria". He remarked that detailed statutory efforts to control wages, as attempted by the previous Administration "fell flat on their

faces /.....

faces in practice". He said that the Government intended to leave the responsibility for the determination of wages where the Government considered it belonged, namely with employers and unions. It is not yet clear what measures the new Administration proposes to take to reduce the rate of inflation.

In the next chapter we propose to consider monetary policy in general, and money supply in particular, in relation to incomes policy. Thereafter, in Chapter VII, we shall try to evaluate the development of the British incomes policy and to make some assessment as to whether direct intervention by the State in the mechanisms for determining incomes and prices was materially successful in curtailing the rate of inflation.

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CHAPTER VI.

It was stated in the Introduction that incomes policies have always been applied in conjunction with other policy instruments. It is, therefore, necessary to examine the complementary policies in the United Kingdom to assess whether they were appropriate in the prevailing economic conditions or whether they served to impede or negate the objectives of the incomes policy. In particular, the relative importance attached to the supply of money in the formulation of monetary policy may be of considerable significance in fostering the success of an incomes policy designed to reduce the rate of inflation. It is intended in this Chapter to trace very briefly the monetary policies pursued by successive governments during the post-war years culminating in the enunciation of the concept of Domestic Credit Expansion in May 1969 by Mr. Roy Jenkins, the Chancellor of the Exchequer.

After the termination of the Second World War, the Labour Government under the Prime Minister, Mr. Attlee followed a policy of cheap money. Bank rate remained unchanged at 2 per cent until November, 1951. There was relatively little control over the supply of money. The Government endeavoured to control aggregate demand and inflation, mainly through severe fiscal measures and a continuation of the battery of war-time controls, including rationing and price control. E.V.Morgan commenting on monetary policy during this period observed that "it was decided ..... that borrowing should be cheap and easy for the Government and for those whose projects had government approval, while the expenditure of others was restricted by direct controls"(1).

Sir/....

(1) E. VICTOR MORGAN. "Monetary Policy for Stable Growth" Hobart Paper no. 27 Third Edition p. 15.

Sir Stafford Cripps, the Chancellor of the Exchequer in 1947, continued the cheap money policy of his predecessor, Mr. Hugh Dalton. In 1947, for example, the ratio of money stock to Gross National Product was 0.76 as compared with 0.40 in 1961 and 0.34 by 1969. The economy was at the time, almost "saturated" with money, but it appears that people had not yet come to expect inflation to the extent that they anticipated increases in the price level during the following two decades. However, in view of the controls already mentioned, inflation was probably only "suppressed" during the immediate post-war period. The increase in the money supply could not, as modern quantity theorists predict, cause a significant increase in output in view of the government restrictions on industrial production. In 1951 when the General Election returned the Conservatives to power, relatively more attention was concentrated upon monetary policy. The wartime controls were being dismantled with the result that the new Government had to search for other instruments to replace them in the management of the economy. Bank rate was raised to $2\frac{1}{2}$ per cent in November 1951 and to 4 per cent in March 1952. Although in the early years of the Administration, Bank rate was used as an instrument of monetary policy it was only after 1955 that this instrument was administered with considerable vigour. Open market operations by the authorities were also adopted, to influence the capacity of the banking sector to lend to the private sector.

In 1957 the Government decided to appoint a Committee to examine the working of the monetary system. This Committee, commonly known as the Radcliffe Committee, reported in 1959. The Committee listed the objectives of monetary policy as a high and stable level of demand, reasonable stability in the purchasing power of money, steady economic

growth/...

growth and improvement of the standard of living, a margin in the balance of payments which would be sufficient to make some contribution to the economic development of the outside world, and finally, to provide for a "strengthening of London's international reserves". These objectives, indeed, were similar to those of the Government itself, although economic growth had not been specifically included by the latter.

The Committee, although it did not deny that the supply of money was important, considered that "the authorities ...... have to regard the structure of interest rates rather than the supply of money as the centrepiece of the monetary mechanism. This does not mean," the Committee added, "that the supply of money is unimportant, but that its control is incidental to interest rate policy". It is therefore unfair to suggest that the Radcliffe Committee asserted that "money did not matter" but rather that it considered that "money did not matter very much".

Throughout the Conservative Government's period of office and, indeed, during most of the succeeding Labour Government's years in power, the basic monetary policies were not radically changed. Indeed the policies adopted by the authorities from 1964 to complement both the fiscal and incomes polcies were not basically different from those of the Conservative Government. Primarily, they consisted of more severe restrictions on bank lending, the imposition of special deposits by the banks with the Bank of England and the maintenance of relatively higher rates of interest. Control of the supply of money itself and the significance attached to this control by economists of the so-called "Chicago School" such as Milton Friedman, and the development of the "new" Quantity Theory, received relatively little support from the

Government/....

In so far as this policy of supporting gilt-edged securities is pursued it is well nigh impossible to achieve a tight control over the supply of money. Morgan would appear to have explained succinctly the result of this policy when he stated that "the times when monetary control is most needed - when prices are rising fast and the balance of payments is weak - are just the times when the gilt-edged market is likely to be depressed. If, in these circumstances", he continues, "the authorities feel obliged, not only to refrain from selling stock, but also to make substantial re-purchases in order to support the market, it is virtually impossible to avoid additional recourse to the banking system (to meet the Government's current financial requirements) and control over the money stock must be relinquished".(3)

At this juncture it is appropriate to ask what are the main contentions of economists favouring the "new" quantity theory approach and whether they have any empirical basis for their conclusions. Broadly, the empirical work and views of Friedman on money supply may be summarised in the words of Morgan(4) who states that in the short-run "there is a very strong correlation between changes in the quantity of money and changes in the demand for goods and the rate of growth of real output". However, this correlation disappears over longer periods and "is replaced by one between the quantity of money and the price level. When the money stock grows faster than real output, prices rise; when the money stock grows more slowly than real output prices fall; but there is no significant difference in the average rate of growth of real output between long periods of rising prices and long periods of falling prices". The "Chicago School" contend that the supply of money should/...

(3) E.V. MORGAN op cit. p 35

(4) E.V. MORGAN op cit. p 51

should be allowed to grow at a fairly constant rate and that fluctuations in the quantity of money should be avoided. If the lag between a change in the stock of money and its effect on the economy is relatively long, the effect may influence real output in economic conditions which are quite different from those upon which the authorities wished their actions to take effect.[(5)] Friedman and Schwartz concluded from their empirical study that the troughs and peaks in the cycles of economic activity lagged by 12 to 18 months respectively behind previous troughs and peaks in the rate of growth of the money supply. However, it has been argued that the average lags concealed very considerable instability. Furthermore, the debate on the influence of the money supply upon real output has revealed that even if there is a strong causal relationship in this direction rather than a causal relationship from real output to the money supply, the precise "transmission mechanism" is by no means clear. Notwithstanding the apparent lag identified by Friedman and Schwartz, recent work in the United States has suggested that the time-lags associated with fiscal measures imply that fiscal measures are not necessarily faster-acting than monetary measures. The work of Andersen and Jordan[(6)] is particularly interesting in this respect. In an article prepared by M.J. Artis and A.R. Nobay in the National Institute Economic Review,[(7)] an attempt was made to "replicate with United Kingdom data the kinds of test" employed by Andersen and Jordan. The results suggested that fiscal measures were relatively quicker-acting than monetary measures but the authors admit that the results are very far from conclusive.

A.A. Walters/..

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(5) M. FRIEDMAN and A.J. SCHWARTZ: "Money and Business Cycles". Review of Economics and Statistics. 1964.

(6) L.C. ANDERSEN and J.L. JORDAN: "Federal Reserve Bank of St. Louis Review" November 1968and April 1969.

(7) NATIONAL INSTITUTE ECONOMIC REVIEW. August 1969 pp 33-51

A.A. Walters[8] has examined the effect of changes in the money supply upon output from 1955 to 1968. He suggests that "there is some evidence that the downturn of real income at the end of 1955 was brought about primarily by the striking reduction in the quantity of money that occurred in the first quarter of the year .... Prices, however, continued rising as rapidly as before until they levelled out during 1958". During the period from 1957 to 1965, however, it is difficult to show the relative importance of the effects of monetary and budgetary policies. Sometimes they were in harmony and at other times they appeared to be following diverging paths. Perhaps the most interesting period for study was the period in 1967 and 1968 when the money supply was being expanded but there was a severe fiscal policy in operation. Walters[9] observes that from the second quarter of 1967 there was a rapid increase in the quantity of money. "The increase over the year was of the order of 10 per cent ...... even in the second and third quarters of 1968 the money supply was still expanding at the rate of about 6 per cent per annum". Yet despite the "devaluation budget" in November 1967 and the extremely harsh budget the following March, there was a consumer boom. Walters points out that "the consumer boom proceeded apace from the autumn of 1967 on. Retail prices increased from August, 1967 to August 1968 at the rate of 5.7 per cent and industrial production increased by about 6 per cent. Retail sales soared". Walters suggests that the evidence "is .... consistent with the hypothesis that there is about a six-month lag in the reaction of the economy to changes in the stock of money". However, he concedes that the rise in prices from 1955 to 1958 despite the reduction in the stock of money remains the most

puzzling/....

(8) A.A. WALTERS: "Money in Boom and Slump" Hobart Paper No.44 Second Edition 1970 pp 45.

(9) A.A. WALTERS. op. cit. pp 48-49

puzzling feature of the period from 1950. This situation appears on the face of it to be inconsistent with the predictions of the quantity theorists.

Walters regards the most important lesson to be drawn from the 1954-56 and 1967-68 periods is that "in the apparent conflict between monetary contraction (expansion) and budgetary stimulation (damping) the resulting events were more consistent with a monetary theory than with a budgetary model. It would be silly to conclude" he adds, "that the only thing that does matter is money. The evidence is neither sufficiently robust nor sufficiently extensive to suggest such a dogma. More subtle and sensitive interpretation may give more delicately-balanced conclusions".

In May, 1969, the Chancellor of the Exchequer enunciated the concept of Domestic Credit Expansion (DCE) in his letter of intent to the International Monetary Fund. The 'letter of intent' stated that "it is the Government's policy to ensure that the course quarter by quarter of domestic credit expansion as a whole, and of the Central Government borrowing requirement within it, is consistent with the intended result for the year as a whole and to take action as appropriate to this end". The Chancellor, Mr. Jenkins, promised to try to limit DCE to £400 million for the financial year ending March, 1970. What is DCE? "The Economist"(10) described it as "broadly ..... the increase in the money supply excluding the effect of the balance of payments". Walters prefers to define it as the "change in the money supply + deficit on balance of payments. For this purpose", he says, "the balance of payments' deficit consists of the current account deficit plus net private capital inflow plus official lending overseas".

In considering/..

(10) "THE ECONOMIST" 28th June, 1969 - pp 13-14

(11) A.A. WALTERS. Op. cit. p. 56.

In considering the statement by Mr. Jenkins to limit DCE to £400 million "The Economist" calculated that "if Britain's overseas accounts were in exact balance ....(that) financial year, then the new formula would allow money supply to increase by £400 million (i.e. by about 2½ per cent); if we really do get a balance of payments that leads to an inflow of £300 million of foreign exchange, then the money supply should be allowed to increase by some £700 million (or nearly 4½ per cent) but if we again run a balance of payment deficit of £400 million, then the permitted increase in the money supply will be nought". The journal admitted that "there are complications in this rough arithmetic because the concept of DCE includes some illogical items ..... but that is the broad effect." (12) In August "The Economist" observed that the permitted increase of 4½ per cent (assuming an inflow of £300 million) "fits in well with the Milton Friedman formula for keeping inflation under control ('allow the increase in money supply to be only about 1 per cent above the potential for real annual growth of output in the economy')".

Walters, however, considers that the operation of DCE, while having the attractions of the type of discipline imposed by the automatic gold standard system also entails many of its disadvantages. He concludes that "a stable DCE may be worse and perhaps much worse than a stable expansion of the money stock. But, by the same token, some sort of stability in DCE, if extremes are avoided, will provide a useful basic discipline on government behaviour; we must", (13) he adds, "make do with the second best".

It is/....

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(12) "THE ECONOMIST". 2nd August, 1969 pp 13-14

(13) A.A. WALTERS. op cit. p. 59.

It is interesting and, perhaps, significant, that the incomes policy was in a state of almost complete collapse when "for practically the first time since the war, a real squeeze is being laid at the base of the money supply".(14) Although the Government did not intimate that it had lost confidence in its incomes policy as an economic weapon to control inflation and had decided to replace it (rather than reinforce it) with a stricter control of the money supply, the rapid decline of the incomes policy and the subsequent emergence of the new policy provides a ready ground for speculation as to what the Cabinet were really thinking.

We have described in the previous Chapter the rapid rise of wages in relation to productivity and prices in 1969 and the first half of 1970. We have also noted the somewhat unexpected improvement in the visible trade balance in the closing months of 1969. To what extent the lag in the increase in prices and the improvement in the export performance were a result of the stricter control of the money supply during 1969 is impossible to determine at this stage. The "new model monetary policy" - this term is used by "The Economist"(15) - has not been in operation for a sufficient length of time to provide any accurate or meaningful assessment of its effect. However, it is important to remember that the new policy was not a complement to the incomes policy which as already stressed, was in ruins by the middle of 1969, if not before, although the Government's delaying powers of up to twelve months on price and wage increases did not legally expire until the end of the year.

The fears of some members of the Treasury and the Bank of England that the gilt-edged market would collapse if the support hitherto

given/....

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(14) (15) "THE ECONOMIST": 2nd August 1969 pp 13-14.

given it was reduced proved to be unjustified. Indeed, "The Economist"[16] remarked that the Friedman view "that a stop to support buying of gilt-edged could soon lead to a firming up of the gilt-edged market was regarded as crazilly academic. But of course" continued the journal, "this is what has actually happened".

It is necessary to point out that a reduction in the money supply may be offset, at least in part, by an increase in the velocity of circulation. An examination of the relationship in the United Kingdom between gross national product and the money supply for the period 1963 to 1968 shows that a relatively small change in velocity of circulation can reflect a substantial monetary equivalent. The figures below are interesting because, as Artis and Nobay[17] point out, "the monetary equivalent of velocity variations is often substantial in relation to the money supply - sometimes larger[17*] and frequently of the opposite sign ..... The figures could hardly be described as reassuring, since they suggest that a given change in the money supply might be offset or effectively increased by as much as a quarter or a third, by changes in velocity". However, changes in velocity do not necessarily conflict with the views of the "Chicago School". The quantity theorists admit that the velocity of circulation will change but they contend that these changes may be predictable. If accurate prediction of the changes in velocity is possible, monetary policy, through control of the money supply, may enjoy a greater degree of success in the future.

Variations/...

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(16) "The Economist": 2nd August 1969 - pp 13-14

(17) "National Institute Economic Review" op cit. pp 48-49.

(17*) This fact emerges clearly from the detailed quarterly tables which are not included with the annual figures overleaf.

Variations in the income velocity of circulation, 1963 - 1968.

Year	(1) GNP at market prices £m	(2) Money Supply £m	(3) Income Velocity 3=(1)÷(2)	(4) % change in velocity % + / -	(5) Monetary Equivalent of change in velocity £m, + / -	(6) Change in money supply.
	Annual figures					
1963	30,678	10,745	2.85	- - -	- - -	- - -
1964	33,296	11,426	2.91	+ 2.07	+ 222	+ 681
1965	35,734	12,165	2.94	+ 0.80	+ 91	+ 739
1966	37,942	12,974	2.92	- 0.44	- 53	+ 809
1967	39,710	13,759	2.87	- 1.31	- 170	+ 785
1968	42,424	15,091	2.81	- 2.60	- 357	+1,332

(18)

In May 1970, however, the National Institute Economic Review came to the conclusion that "there is not much evidence for the United Kingdom whether a tight control of money supply (associated *ceteris paribus*, with rising interest rates) leads to a deceleration in the rate of price inflation rather than in real output growth, but so far as it goes, it seems that the impact is first felt on real output and employment and only later on prices". Significantly, by the middle of 1970 the level of unemployment was the highest since the end of the Second World War. This level of unemployment may have been the result of other economic factors such as changes in union behaviour, rather than monetary policy.

Perhaps it is not unfair to say that the extent of the influence of changes in money supply upon the rate of inflation is still very uncertain. Although there is a growing support for the Chicago quantity theorists both in the United Kingdom, and especially in the United States, the greatest weakness of their theories appears, so far, to be their inability to demonstrate with clarity and precision how the "transmission mechanism"

actually/....

(18) "National Institute Economic Review" May 1970 p. 19

actually works. Indeed Scitovsky[19] has rightly pointed out that "in today's complex economy, the causal chain through which a change in the supply of money influences the price level is long and tenuous". The expansion of the money supply in the United Kingdom during the period of the incomes policy probably made the implementation of the policy relatively more difficult. It is impossible to say with any assurance, however, to what extent it impeded the policy or hastened its collapse.

Before concluding the discussion on monetary policy it is relevant to ask if the Friedman School, would in practice, deal with inflation in a fundamentally different manner from the supporters of incomes policies. The question is, perhaps, not as surprising as might at first appear. It has been raised by Weintraub[20] in an article referred to by the "National Institute Economic Review".

The "Review"[21], in August 1970, noted that "the question is again being raised today .... whether after all the rate of increase in prices might not be controlled by an appropriately severe fiscal and monetary policy (rather than incomes policy). A special version of this kind of approach" the Review says, "is enshrined in the idea of operating monetary policy according to a rule by which the money supply is predetermined to grow at a fixed rate (so that) ..... ultimately ...... the nominal national income (will) grow also at a fixed rate". They point out that the problem is that it is not known "how a restrained rise in nominal income will be divided between changes in prices, on the one hand, and real changes in output on the other". Therefore, it is not known how long it would take for price increases to fall to the desired level.

Nor/.....

(19) T. SCITOVSKY. "Money and the Balance of Payments" p. 66

(20) S. WEINTRAUB. "Incomes Policy in the Monetarist's Programme" The Bankers' Magazine August 1970 pp.71-76

(21) No. 53. p. 12.

"Nor is there any assurance", remarks the Review, "once such stability was realised, that it could be maintained once a more acceptable rate of real economic advance and untilisation of resources was restored". The Review then referred to a recent article by S. Weintraub. It had been suggested by Weintraub that the Friedman argument favouring a constant rate of growth of the money supply, assumes that labour will acquiese in allowing unit labout cost to remain stable. "The big issue" observes Weintraub, "thus concerns the trend of wages under Friedman's monetary rule; the penalty is to be unemployment if labour does not bend to the monetary clamp .... Yet Friedman himself is the authority for the view that while a <u>change</u> in money supplies bears a good relationship to the <u>change</u> in money income, the split between price and output is vague and unpredictable". Weintraub argues that "entailed in the Monetarist programme is either a voluntary or a legislated Incomes Policy", because the programme will only succeed if it gains the co-operation of labour "through a new agreement or through the imposed discipline of new laws". He suggests on past experience that "any expectation of enthusiastic labour acquiescence is out of harmony with the facts". If Friedman's view requires labour compliance "we see the convergence in the Monetarist and wage theories of inflation: <u>both premise an appropriate wage trend to control the price level"</u>.(22) If labour is unco-operative what is the monetarist's solution to unruly wage movements? asks Weintraub. He concludes by observing that "a country can never embark on a policy in the conviction of complete success. As with the military, it must have some programme in reserve, for tactical or strategic support.

Is it /....

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(22) WEINTRAUB has written the underlined words in italics for emphasis.

Is it an Incomes Policy, in the case of the Monetarists"? Thus, the manner in which the "Chicago School" seeks to control inflation may not be so different, in practice, from the supporters of incomes policies.

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CHAPTER VII

An attempt to assess the value of an incomes policy to a country's economy must be made in terms of what it is designed to achieve. The initiators of the policy itself and the administrators concerned with its day to day implementation must evaluate the results in the light of the objectives. This statement is, no doubt, obvious but it is, not infrequently, lost sight of. An incomes policy may be roundly condemned for failing to halt inflation or to re-distribute incomes within the country, or for not encouraging investment and saving, or for its inability to improve the balance of payments and ensure full employment with a high rate of economic growth. The validity of any criticism rests, therefore, on the success or failure of the policy to achieve the aims for which it was established and on whether it was the most appropriate economic instrument for carrying out the job. Admittedly the evaluation is made more difficult when the relative importance attached to various objectives is equivocal and also where these objectives have themselves changed in emphasis over time.

In trying to judge the success of the British policy we shall look at its achievements in the light of its intention to assist in reducing the rate of inflation without excessive unemployment. This was certainly its principal aim. If inflation had not been so acute a problem it is most unlikely that the policy would ever have been embarked upon. At most, the incomes policy would have been very different to the one established had inflation not been its central objective. However, it must be recognised that the British incomes policy did have other objectives besides maintaining a high level of employment without incurring inflation at the same time. There were social as well as economic

aspects/.....

aspects, such as the maintenance of a reasonable standard of living. Indeed the White Paper in November 1966 stated that "improvement in the standard of living of the worst-off members of the community is a primary social objective". The White Paper added that "as in practice the needs of individual workers are largely determined by the extent of their family commitments, the Government will continue to give a high priority to measures specifically designed to meet family needs".

It will be recalled that the "Declaration of Intent" signed in December 1964 accepted the need to keep increases in income in line with the increase in real output. In addition, both sides of industry accepted the Government's proposals set out in the White Paper in 1965 (1) that the National Economic Development Council should "keep under review the general movement of prices and of money incomes of all kinds". Furthermore, they accepted that the National Board for Prices and Incomes should be set up "to examine particular cases in order to advise whether or not the behaviour of prices or of wages, salaries or other incomes (was) in the national interest as defined by the Government after consultation with Management and Unions".

We have already indicated that the attempt to impose a voluntary incomes policy was a failure in so far as it did not achieve the restraint necessary for preventing inflation. The retail price index, the capital goods index and the index for total final prices are set out below. The base year is 1958 and the increase in the indices from 1956 is not without considerable interest in so far as the index for total final prices rose from 113.1 in 1964 to 122.3 in 1966. (2)

Retail/....

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(1) Cmnd 2639. April, 1965. Op cit.

(2) "NATIONAL INSTITUTE ECONOMIC REVIEW". No. 46 November 1968 p. 71.

		Retail Prices	Total Final Prices.
		1958 = 100	
1966	I	123.4	119.4
	II	125.8	121.4
	III	126.2	123.7
	IV	127.2	124.3
1967	I	127.9	123.9
	II	129.0	124.5
	III	128.3	125.8
	IV	129.9	126.5
1968	I	131.7	127.5
	II	134.8	130.7
	III	135.5	132.7
	IV	137.2	132.8

From the third quarter of 1966 to the end of 1967 retail prices rose from 126.2 to 129.9. This amounted to approximately 3 per cent over the eighteen months. During the whole of 1967 they rose by only 2 per cent. In order to try to find some indication as to whether it was the "freeze", rather than the "squeeze" imposed by severe fiscal and monetary policies, which caused the check in the rise in prices, it is not very helpful to look at the indices for the level of unemployment, unfilled vacancies and "excess demand". The following tables reflect the demand for labour from 1957 as depicted by these three indices.

DEMAND/...

DEMAND FOR LABOUR.

Percentage of Labour Force.

		Unemployment	Unfilled Vacancies	(Thousands) Excess Demand.
1957		1.37	1.26	-13
1958		1.86	0.91	-208
1959		1.97	1.02	-209
1960		1.50	1.40	-22
1961		1.35	1.42	15
1962		1.84	0.93	-208
1963		2.17	0.85	-304
1964		1.56	1.37	-44
1965		1.32	1.64	75
1966		1.38	1.57	46
1967		2.21	1.07	-265
1968		2.35	1.17	-272
1966	I	1.18	1.73	129
	II	1.20	1.79	140
	III	1.37	1.58	51
	IV	1.77	1.19	-136
1967	I	1.97	1.17	-186
	II	2.18	1.07	-259
	III	2.38	0.99	-325
	IV	2.31	1.07	-289
1968	I	2.21	1.17	-241
	II	2.38	1.17	-279
	III	2.51	1.12	-320
	IV	2.30	1.23	-248

Although at first glance it might appear that the "freeze" rather than the "squeeze" in 1966 and 1967 was the major cause of the decrease in the demand for labour as there was an immediate change in the demand for labour in the third quarter of 1966, this in fact proves little or nothing as the whole deflationary"package" in that year must be seen as a

comprehensive/...

comprehensive economic assault on the inflationary spiral. It is not possible to establish any accurate apportionment of the change in the demand for labour to any one instrument of policy, though this was the first peace-time occasion in which an incomes"freeze" was instituted.

The Board for Prices and Incomes in its Second General Report, in August 1967, concluded that "it cannot be said with any exactitude what would have been the effect of the "squeeze" without the "freeze" .... It is reasonable to assume, however, that the "freeze" played a major role in slowing down the momentum of inflation, and that without it the disinflationary effects of an even more severe "squeeze" would have taken longer to show themselves". This is probably about as far as one can go in assessing the relative significance of the different economic policy measures and, indeed, it may be questioned whether the effects of a statutory "standstill" on incomes can ever be accurately calculated until there are a number of case studies which may provide guidance and suggest trends.

The deflationary measure in 1966 and 1967 did not result in the hoped for improvements in the balance of payments on the trading account. However, there was an absolute decline in the gross domestic product over one quarter - April to June, 1966 -- and the figures showed that there was no growth whatever from the fourth quarter of 1965 to the fourth quarter of 1966, while for the following eighteen months until the middle of 1968 gross national product rose from 129.8 to 135.0, an increase of about 4 per cent or at an annual rate of about 2.7 per cent. Perhaps, more importantly, the industrial production index for the first quarter in 1966 was 134 and in the final quarter declined to 131. In 1967 this index was 132 for the first quarter and 136 for the fourth quarter.

The/....

The index for "distribution and other services" remained at 125 for the whole of 1966 and rose from 126 in the first three months of 1967 to 130 by the last quarter of that year.

What do these statistics suggest? Bearing in mind the lags inherent in the effect of policy measures, the "standstill" and "severe restraint", together with greater control over the creation of credit, resulted in a decrease in the rate of inflation, a stagnation in aggregate production, a higher level of unemployment and from the figures below, no significant improvement in the country's trading position. Does one therefore conclude that they were the wrong economic measures, if the country's performance in international trade did not improve or may it be justifiably claimed that the balance of international trade would have been much worse if they had not been imposed? For the eight quarters in 1966 and 1967 the adjusted balance of visible trade was as follows:-

		£ million.
1966	I	- 69
	II	- 98
	III	- 57
	IV	+129
1967	I	- 19
	II	-111
	III	- 77
	IV	- 332

It is hardly surprising that devaluation seemed to be the only alternative by November 1967. Other measures including the incomes policy had proved to be insufficient to remedy the situation. Although prices were rising at a relatively slower rate, exports were still not competitive on

the/...

the international market. The loss of confidence in sterling and the deterioration in the United Kingdom's export performance were too great for the incomes policy to put matters right by directing its attack on the rising price level.

It may be asked at this juncture what happened to productivity. Did the economy become relatively more productive as a result of managing the country on a much tighter rein? Even if devaluation was the only solution to an over-valued pound, it might be expected that there would still have been some favourable results flowing from the severe policies adopted.

There was a decrease in overall demand for consumer and capital goods; accordingly, there was a greater margin of spare capacity in the economy. At the same time, the decline in profits provided a strong incentive to management to decrease costs wherever possible. This would result in a substantial "shake-out" in industry which should help to increase, in the longer-term, output per person employed. In the following table output per man-hour worked in manufacturing industry does show that output started to decline in the second period in 1966, but this cannot be attributed to the "freeze" which was instituted only in the third quarter of that year. It is therefore difficult to establish to what extent the "freeze" did affect output per person both during the period of its operation, and in view of time-lags, after its termination. The index for manufacturing output per man-hour worked is compared with the indices for hourly earnings and for average weekly hours since 1957. In the ten quarter from January 1966 to July 1968 hourly earnings rose from 159.3 to 179.1, whereas weekly hours worked rose not at all.

More/......

More significantly, productivity declined slightly and then rose rapidly in the last quarter of 1967 suggesting that the effects of the "freeze" and "squeeze" were at last having a beneficial effect upon productivity.

		Output per manhour worked in manufacturing industry.	Hourly Earnings In	Average Weekly Hours Manufacturing.
			1958 = 100	
1957		99	95.9	101.0
1958		100	100	100
1959		105	104.2	100.8
1960		110	112.0	99.9
1961		110	119.6	98.5
1962		113	124.0	97.6
1963		119	128.8	97.5
1964		126	137.7	98.2
1965		130	149.0	97.0
1966		133	160.5	95.5
1967		137	167.1	94.8
1966	I	135	159.3	95.6
	II	132	161.5	96.2
	III	133	160.3	95.8
	IV	134	161.5	94.3
1967	I	137	163.2	94.1
	II	136	166.3	94.9
	III	136	167.5	95.2
	IV	140	171.0	95.1
1968	I	144	178.2	94.5
	II	144	179.1	95.5
	III	145	179.2	96.1
	IV	147	183.1	96.0

The discussion/....

The discussion of the effects of monetary policy in Chapter VI revealed that we possess no accurate guide to determine how long changes in monetary policy in the United Kingdom take to cause changes in the economic situation. We therefore do not know how much of the change in the economic position was due to the incomes policy itself. The relatively sharp change soon after the 1966 "freeze" is, as we have pointed out, no sure guide to its success as it was not the only instrument used. (3) E.V. Morgan in considering British monetary policy stressed the importance that "stabilising measures should be quick acting, and here monetary policy does not score very high marks. Fiscal changes such as the "regulator" changes in indirect taxes, a variable social insurance contribution or changes in hire-purchase controls all exert a much more immediate impact". He adds that "the real power of monetary policy is in influencing economic conditions over rather longer periods". This suggests that the fairly sudden change in 1966 in employment levels, output and productivity were mainly due to measures other than changes in Bank rate or in controls over bank lending. However, it is difficult to be more precise on this issue.

It is worth tracing the views of the Prices and Incomes Board during the first four years of its existence from 1965. It issued four General Reports at annual intervals. We have, of course, referred to some of these Reports already.

In its First Report it emphasised that its recommendations had no binding effect and as such "the Board operated within the framework of a 'voluntary policy'". We have discussed this voluntary aspect at some length earlier. In its Second Report the Board remarked that it "was

no longer/...

(3) E.V.. MORGAN: "Monetary Policy for Stable Growth". op cit. pp. 30-31

no longer operating to rules which were the result of tripartite agreement; it could reach its judgment only in the light of the exceptions to the stand-still laid down by the Government"(4). The Government had the power to enforce the Board's findings but in fact it did not have occasion to do so. When the Government did intervene on a few occasions during the period from July 1966 to August 1967 to prevent increases in prices and wages being put into effect the specific issues had not been referred to the Board. The Government was acting in terms of Part IV of the Act passed in August, 1966.

The Board claimed that the joint "squeeze" and "freeze" could be "expressed in short-run economic terms and long-run institutional terms"(5). We have already dealt with the Board's view on the effect the measures had on industrial production, output per head and earnings. It remains for us to consider the Board's view of the question of price stability. The Board pointed out that over the twelve month period the retail price index rose by 1.4 per cent in each period(6). Overall this index showed a rise only of about 0.8 per cent more than the rise in average earnings. As a large section of the public had no increase in wages, it is clear that for them there had been a fall in their standard of living during the short period.

What was, no doubt, even more important was that over the period export prices rose by less that one per cent. Although to some extent this was due to price reductions in imported raw materials, the combined stringent economic measures obviously helped. The Board concluded

that/....

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(4) "Second General Report" op cit. pl. July 1966 - August 1967

(5) "Second General Report" op cit. pp 4-5

(6) This statistic is supported by the table set out above on page 115, which is taken from the Quarterly Journal, "National Institute Economic Review" whose statistics are obtained from various official sources such as the Department of Employment and Productivity Gazette/........

that "this comparative stability in export prices - combined with similar stability in the prices in home manufactures generally, is probably the main economic gain derived from the period of 'squeeze' and 'freeze' "(7). This was, perhaps, an ironic comment in view of the devaluation of sterling less than six months later in November, 1967.

The Board also addressed itself to the contention by some economists - notably F.W. Paish, - whose views we shall examine shortly, that a 2 to 2½ per cent level of unemployment giving a roughly 5 to 6 per cent level of surplus capacity should result in a negligible change in prices. The Board observed that the specific references on pay and prices to it over the period did not support that contention, although it admitted that these references were clearly limited in number and presumably, by implication, insufficient to disprove the thesis that a reduction of demand, sufficient to raise the level of unemployment to 2½ per cent or so, would result in price stability in the United Kingdom. Paish and others have suggested that the Government's mandatory incomes policy was unnecessary and inappropriate. Paish has, moreover, argued his case both before and after its imposition.

In the Board's Third General Report issued a year later in July 1968, the incomes policy was seen in the light of the effect of the devaluation and probably the harshest Budget since the end of World War II, in March, 1968. The harsh Budget was not unexpected. The increase in earnings from April, 1967 to April, 1968 was more than 8 per cent and prices rose by about 4½ per cent leaving as the Board pointed out "an increase in real purchasing power of 3½ per cent in a period which

started /.....

(6) cont.: Gazette, Economic Trends (HMSO) Monthly Digest of Statistics and the Board of Trade Journal (HMSO).

(7) "Second General Report". op cit. p. 5.

started with an appreciable balance of payments deficit".[8] However, despite the rise in earnings, unemployment, seasonally adjusted, rose from 1.9 per cent to 2.3 per cent during 1967 and was still at 2.3 per cent in April 1968 whereas the retail price index from April 1967 to April 1968, rose by 3.7 per cent. The Board remarked on the surprising nature of these changes in view of their different relationship as compared with previous levels of unemployment and increases in wage rates. This appears to indicate as, indeed, the Board suggests "a loosening of the relationship between variations in earnings and variations both in the demand for labour and in prices". From a study made by the Board over the previous twenty years this relationship appeared closer in the first decade than in the second and the experience in 1967 and 1968 appeared to highlight this trend. The Board offered possible explanations. Industry may have simply regarded the wage increases as being "deferred" during the earlier period although the Government had sought to counter any such supposition. Moreover, the militancy of the unions may have reflected a marked increase. These explanantions appear similar to those offered by Professor Paish. The Board remarked that "it is just possible, indeed, that the more frequently a 'freeze' is imposed the greater is the subsequent militancy of claims".[9] A model constructed by Lipsey and Parkin would appear to lend support to this suggestion. The model will be described shortly. Another possible explanation suggested by the Board was the combination of two things, namely, the increase in the rate of change in output per head and the impact of rising output directly on such pay as is related to output and indirectly on all workplace, enterprise or company wage settlements.

In its/......

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(8) "Third General Report": p. 5

(9) "Third General Report": op cit. p. 12.

In its Fourth General Report in July, 1969, the Board returned to the question of money earnings rising at a greater rate than during the previous periods since the War when unemployment was at a comparable level. The relatively high level of unemployment continued to exercise a less moderating effect on the rate of growth of money earnings than in the past. Between April 1968 and April 1969 "unemployment (seasonally adjusted) remained at between 2.2 and 2.6 per cent as against an average of 1.7 per cent in the decade from 1958 to 1967."(10) The Board also pointed out to underline the new trend that "the index of weekly wage rates rose by 5 per cent and of average weekly earnings by 8.8 per cent as compared with averages of 3.7 and 5.5 respectively in the previous decade. Moreover, the average increase in productivity during 1968 and 1969, as measured by output per head, was significantly higher than in the previous decade - 3.7 per cent as compared with 2.7 per cent.

Professor Paish is among those economists who have remained very critical of the Government's incomes policy. His views are worth consideration since his paper, "Policy for Incomes", published in 1964, is not materially different in the views it expresses, from his paper published in 1969,(11) the interval having included the compulsory incomes policy instituted in 1966 and its subsequent relaxation and final "collapse". Paish states that "the return to voluntary methods (of wage and price determination) in the second half of 1967 showed that the increases had been merely postponed". The policy, if viewed in a long-term light, must therefore surely be regarded as largely a failure. Paish compares this period of two years from mid-1966 to mid-1968 with two other periods in 1957-59 and 1961-63 when there were also disinflationary fiscal and

monetary/.....

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(10) "Fourth General Report" July 1968 to July 1969 (Cmnd 4130) - p.4.

(11) F.W. PAISH: "The Rise and Fall of Incomes Policy". Hobart Paper No. 47. June, 1969.

monetary policies pursued, including the unsuccessful "pay pause" introduced by Mr. Selwyn Lloyd on 1961. Paish concludes that the "productive potential" and output were roughly similar in all three periods and the "incomes policy in the third period did not result in any significant reduction in the rate of increase in incomes as the comparable rate of wage increase in the two earlier disinflationary periods was also between 4.6 per cent and 4.9 per cent per annum respectively."(12)

Professor Paish asserts that "on the face of it, these results suggest that the much more vigorous enforcement of an incomes policy in 1966-1968 than in either 1957-59 or 1961-63 has on balance had no effect at all". He admits, however, that "such assessment would, however, probably be unjust", for two reasons in particular. The first is that in the two earlier periods there was not the urgent need to shift resources from home consumption to manufacturing for export so that domestic consumption did not have to be so severely restricted and there was therefore not as great an incentive to "catch up" later when restraint was relaxed. In 1966-67 there was an "almost complete check to the rise in consumption" which, observes Paish, was achieved partly by a rapid rise in prices of consumption goods and partly (contrary to the general impression) by an increase in personal saving".(13) Paish also suggests that another reason for the "faster rise in incomes than was in the past consistent with similar levels of unemployment may have been the introduction of redundancy payments and more generous unemployment benefits which reduced the urgency of finding work and so reduced the supply of labour on the labour market at any given level of unemployment".(14)

Another/...

(12) F.W. PAISH: op cit. p 52.
(13) F.W. PAISH: op cit. p. 52. It will be recalled that the "Second General Report" of the Prices and Incomes Board noted that from July 1966 to July 1967, although price rises were relatively restrained, they, in fact, rose more than wages. The "rapid rise in prices of consumption goods" should presumably be interpreted in the/...

Another explanation for the changed relationship is suggested by the Government itself as well as other economists. The change in structural unemployment may have made itself felt in so far as those who became unemployed were unable to supply the type of skills required by those industries demanding labour, so that wages would tend to rise relatively more despite the actual increase in the level of unemployment as compared with previous periods.

It is important to point out that Paish has not argued that there is any necessary permanence inherent in the relationship between the rate of increase in wages and the level of unemployment, nor that the change in the relationship in the period from 1966 to 1968 was a "freak" result. Although he has provided evidence to suggest that whenever the margin of unused capacity has fallen below about 6 per cent price inflation has resulted and trade deficits have appeared, he does not contend that there is nothing that can be done to reduce this margin without causing inflation. He states that one of the most important factors which determine the necessary margin of unused capacity "is certainly the rate of growth of capacity itself. The higher the rate of growth of capacity, the higher the rate of income growth that is compatable with long-term price stability, and since the rate of income growth is assumed to vary inversely with the margin of unused capacity the smaller is the margin of unused resources needed to prevent inflation. So far from creating unemployment" he adds, "a high rate of technical progress makes a low level of unemployment compatable with stable prices". (15) Paish also agrees that "the mobility and adaptability both of employers and employees .....(and) .... the strength and policies of the trade unions" will influence the size of the necessary/....

(13) Cont.:the light of their relationship to the rise in wages over the same period.

(14) F.W. PAISH: op cit. p. 53

(15) F.W. PAISH: "Studies in an Inflationary Economy" p. 32.

necessary margin. Accordingly, if the economic conditions that have prevailed in the United Kingdom since the War can be changed the level of unemployment and the margin of unused capacity may be reduced without causing inflation. Paish has pointed out that "a country with a 2 per cent per annum rate of growth and a 2 per cent per annum rise in incomes will remain fully competitive with a country with a 5 per cent per annum rate of growth and a 5 per cent per annum rise in incomes ...... The margins of unused resources and unemployed labour required to prevent incomes from rising by more than 5 per cent per year are considerably smaller than those needed to prevent them rising by more than 2 per cent a year, and the social and political difficulties of maintaining them consequently less. An increase in the rate of growth of capacity", he adds, "will therefore not only increase the rate of growth in the standard of living, but will also facilitate the maintenance of stable prices and an adequate balance of payments".

It follows that the observed historical relationship between inflation and the level of unemployment in the post-war years is not a situation that must be accepted as unalterable. Changes in the economy could produce a faster rate of growth without a higher rate of inflation. It is the practical difficulties of promoting these changes in the United Kingdom that have made the relationship identified by Paish appear to be almost impossible of improvement. Indeed, the changes in the past four years have suggested that the situation is indeed, deteriorating, because a particular level of unemployment is now associated with a relatively higher rate of inflation than before. The recent investigation described below is relevant to the discussion of this change in relationship in view of the increased significance attributed to the factor of trade union aggressiveness.

An/.....

An empirical study by Lipsey and Parkin[16], in 1970, of the British incomes policy, concludes that "incomes policy tends to reduce the rate of wage inflation at levels of unemployment below 1.8 per cent, but to increase the rate of inflation above what it would otherwise have been when unemployment is above 1.8 per cent". Their model is especially interesting as it suggests that "a policy that combines an incomes restraint with the depression of aggregate demand sufficient to remove all inflation will require a much higher level of unemployment than will a policy that relies solely on depressing aggregate demand without wage restraint ..... On the other hand, a policy that accepts a moderate-to-large rate of inflation and seeks to reduce unemployment to the lowest possible level may be more successful with an incomes policy than without it".

The model includes four periods[17] when an incomes policy of some kind was in operation as well as periods when there was no incomes policy and where the "conditions were as free from policy-on influences as we could make them". Two reduced-form Phillips curves were described from the data selected. The steeper of the two curves, in the diagram below, represents the policy-off situation whereas the flatter curve shows the policy-on effect. The curves intersect at a level of unemployment of 1.8 per cent and a rate of change of wages of $4\frac{1}{4}$ per cent.

Lipsey and Parkin assert that "the moral of the story is that to break the existing relation between excess demand and wage rises and to replace it by a constant (plus a much weakened association with

excess/....

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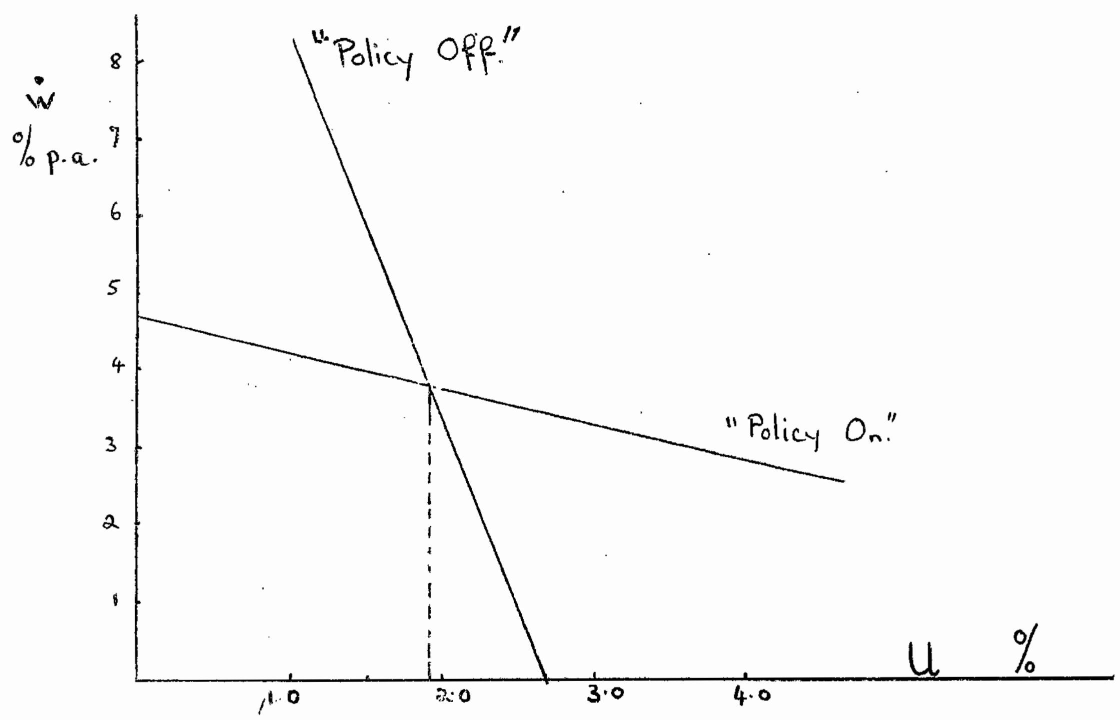
(16) R.G. LIPSEY and J.R. PARKIN "Incomes Policy: A Re-appraisel". Economica May 1970.

(17) (i) 3rd Quarter 1947 to 3rd quarter 1950.
(ii) 1st " 1956 to 4th " 1956.
(iii) 3rd " 1961 to 3rd " 1964.
(iv) 4th " 1964 to 1970.

excess demand) is not an unmixed blessing". They contend that such a policy "has most to recommend it if the economy is to be run at a very high level of demand and some inflationary price rises accepted. If an attempt is to be made to <u>reduce demand</u> sufficiently to keep increases down to the level of increases in productivity (so that an approximately stable price level is achieved), then a reasonably successful incomes policy (with a wage norm) would seem to make the achievement of the goal very much more difficult than if no such policy were operated".



The model reveals that the factor of union aggressiveness is insignificant when there is no incomes policy but that it is very noticeable in the "policy-on" situation. Such a conclusion may be soundly based in view of the increased militancy of the unions, especially during the past three years in the United Kingdom. "Thus incomes policy", suggest Lipsey and Parkin, "seems to create a relation between wage rises and union aggressiveness where none existed before". This factor of union aggressiveness finds support from the earlier study by A.G. Hines, whom it will be recalled, contended that aggressiveness was a significant cause of the rate of increase in wages.

Harry G. Johnson/......

Harry G. Johnson has considered the work of Lipsey and Parkin which he says argues "that the purpose of incomes policy is to change the slope of the Phillips curve (specifically to flatten it) rather than to change the constant term that determines its location".(18) He observes that their "empirical work ...... shows that incomes policy, interpreted this way, has in fact been successful, but that because the policy-makers have reduced the level of employment simultaneously with the introduction of incomes policy, they have in fact achieved the pessimum result of increasing both the level of unemployment and the rate of inflation".(19)

Turning to the longer-term implications of the British incomes policy, can we discern any significance in the changed relationship between productivity, unemployment and earnings? At this stage no long-term trend can, of course, be established with any assurance, although in the second half of 1969 and the first half of 1970 there was a continuation of the rapid rise in wages despite a level of unemployment not experienced in Great Britain in peacetime since the Second World War. Prices, while lagging behind the rise in wages, were by the middle of 1970, showing marked increases as would be expected if labour costs rose. On the face of it the situation would suggest largely a "cost-push" inflation in this period, caused mainly by the increased militancy of the unions and the unwillingness of the Labour Government to apply any effective controls on their monopoly power. It is too soon to conclude that the present change will be permanent or to predict the direction of the long-term trend.

The Board/....

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(18) (19) HARRY G. JOHNSON: " Recent Developments in Monetary Theory - A Commentary" "Money in Britain 1959-1969" Edited by David R. Croome and Harry G. Johnson. p. 113.

The Board for Prices and Incomes suggested earlier when considering the somewhat inexplicable increase in productivity, that this increase, despite the excess capacity and the level of unemployment, may have been due in part to the new and greater emphasis placed on the importance of productivity agreements and industrial efficiency which these agreements could create. The Board itself has issued two Reports on Productivity Agreements, in June 1967 and August 1969, setting out guidelines for such agreements.(20) Indeed the Board claims that "it is ... . clear that the evidence upholds the belief we expressed in Report No. 36 that 'a prices and incomes policy can provide the most favourable encouragement for successful productivity agreements'".(21)

The result of the trend towards increasing productivity has been that labour costs per unit of output have increased at a slower rate from 1967 to 1969 than in previous years. The following table, published by the Board in its Fourth General Report is of interest in this regard. The figures are taken from the Government Central Statistical Office, Department of Employment and Productivity.

	Annual percentage increases. in		
Year or Years covered at constant prices.	Output per head.	Hourly wage earnings	Wage and Salary cost per unit of output.
1957 - 1966 (average)	2.2	6.1	3.1
1967	2.9	4.0	2.3
1968	4.0	7.7	2.4

Nevertheless, as the Board points out, this encouraging trend from whatever cause, whether due to the incomes policy or not, is less pleasing when compared with other Western European countries. The percentage change over previous years of wage and salary costs per unit/.....

(20) "Productivity Agreements": Report No. 36. Cmnd 3311
"Productivity Agreements": Report No.123 Cmnd 4136

(21) Cmnd 4136. op cit. p 31.

unit of output in manufacturing in certain European countries as compared with the United Kingdom is as follows:-[22]

Country	1964	1965	1966	1967	1968
France	3.6	2.6	-0.7	3.9	-
Western Germany	1.6	3.9	4.1	-1.4	-2.7
Italy	11.3	-3.2	-2.7	5.7	-
Netherlands	6.4	7.0	6.0	2.0	-1.0
Sweden	2.6	2.9	3.4	3.1	-
United Kingdom	1.4	5.6	4.8	2.4	1.5

It is worth noting that without any voluntary, let alone mandatory, incomes policy, the experience of West Germany must be not a little chastening to British industry and to the British Government.

Even if we were to concede that the "freeze" and the incomes policy pursued after the "freeze" was terminated, may have had rapid and significant beneficial effects in the short-term before its disintegration through lack of Government resolution or other reasons, the longer-term results may be more important, although they are much more difficult to identify with certainty. For in the longer-term some of the economic issues are of a rather different kind. Here the problem of changing attitudes in industry is of great significance. Ingrained and firmly established attitudes by unions to long-standing differentials for different jobs are not quickly susceptible to change. The problem of wage "comparability" touched on earlier is also not easy to change. Disputes over the demarcation of jobs sustained for many years need very careful handling if they are to be solved. The problems raised by the institutional framework in the United Kingdom may also provide many obstacles to efficiency and economic growth, and may impede a more economically sound wage and income structure. The longer-term issues therefore raise considerations of changing the whole pattern of

industry/....

(22) Source: "The European Economy in 1968" U.N.E.C.E.

industry and the social and political climate in which industrial production is carried on. An incomes policy if designed purely to combat inflation may possibly achieve this by short-term measures such as stringent controls over prices and wages but it may in the longer-term assist in directing or at least guiding the behaviour and attitudes of both sides of industry. It may do so but there is no certainty that it will, because if the trust and confidence essential to change long-standing habits cannot be fostered because of the hostility and suspicion existing within the society, there is little likelihood that any incomes policy will be successful except in the short-term. Even then it may be that other economic measures would have achieved as much with less ill-will.

It has frequently been claimed, probably with a good deal of justification, that the highly decentralised form of collective bargaining in the United Kingdom has militated strongly against a successful incomes policy. The traditional system has been evolved as sectional collective bargaining. This form of bargaining has been accompanied by no central co-ordination with the result that the agreements made have been arrived at independently of what may have been agreed between unions and employers elsewhere in the economy. The Trades Union Congress has no effective control over its members. It does not, for example, control strike funds. This sort of central union control can undoubtedly be an effective weapon. On the other side of industry, the central employers' organisation, now known as the Confederation of British Industries (the result of the merger of three former organisations) is in a rather similar position in regard to its members. It has no control over their decisions.

It must also be remembered that collective bargains in the United Kingdom are voluntary in that they are not legally binding contracts. This means that they cannot be enforced in a court of law. Thus

"unofficial"/...

"unofficial" strikes for any grievance, whether sound or not, are prevalent, particularly where there is militancy among union officials on the shop floor. They cannot be effectively controlled by the union leaders.

An added complication in Great Britain is that there is a great deal of inter-union rivalry, and competition for members. This, in itself, may provoke excessive pay claims and may create more work stoppages through strikes as unions attempt to retain and expand membership on the basis of obtaining relatively better pay or other working conditions from employers. This makes acceptance of an incomes policy which institutes some central direction and control much more difficult. The traditional barriers to acceptance built into the institutional structure are therefore much stronger in the United Kingdom than in some other European countries. The debate as to what should be done to improve industrial relations has ranged far and wide from supporters of highly centralised negotiations to those who would prefer to rely almost exclusively on work-place bargaining. Possibly what is most needed if an incomes policy is to be workable is some structure along the lines suggested by A. Flanders,(23) that is, "a fully developed three-tier system of industrial relations .... a top tier of central or truly national negotiations above industry level and another bottom tier for supplementary and compatable workplace negotiations". But the problems of getting such a system permanently off the ground will be immense.

It would not be inapposite here to consider, very briefly, the Scandanavian machinery for wage negotiation. Economists, in despairing of the British system, have sometimes held up the nordic countries as examples of how a wage determination process should operate.

It must/...

(23) ALLAN FLANDERS: "Industrial Relations : What is wrong with the system? An essay on its Theory and Future" (1965) p. 49

It must be said at once that in Sweden, Norway, Denmark and Finland there is no compulsory incomes policy as there has been in the Netherlands. Furthermore, the machinery in each country is different though there are significant similarities. In addition, there have been and still are severe stresses and strains in the wage bargaining system. Restraint has not always been evident in negotiations. The systems in these countries are far from ideal and inflation has been just as prevalent and worrying as it has been in the United Kingdom. Price controls are not unknown but only Denmark has experienced a "freeze" on incomes.

It is necessary to understand that the central negotiations between the employers organisations and the representatives of organised labour "results essentially in a 'frame' agreement setting certain limits to subsequent bargaining within the individual branches", observes the United Nations' Report "Incomes in Postwar Europe".(24) It adds that "central-bargaining sets the strategy and pattern for industry bargaining, or for bargaining at the local or enterprise level. It is not a substitute for sectional bargaining". There is no government determined ceiling to wage increases.

Nevertheless the central 'frame' does help to provide co-ordination that is economically valuable. It offers a way to achieve an overall appreciation of how wage changes are likely to affect the economy as a whole. Forecasts of price increases and wage costs per unit of output can be made more readily. It obviously helps in the management of the economy to have a more accurate guide to changes in wages, and

their /.....

(24) op cit. Chapter 4, p. 5.

their likely effect on the economy, so that the use of other economic instruments may be applied when necessary. In so far as the central bargaining of wages effects incomes policy, the United Nations Report lists the main characteristics as being "the inevitable involvement of government in the decisions and an inevitable concern on the part of the negotiators with general considerations of economic policy."(25) The significance of these characteristics is that negotiators are, in practice, obliged to concern themselves with the economy as a whole. They cannot escape into independant sectional bargaining and disregard national considerations. Thus, despite the fact that individual unions are naturally pre-eminently concerned with their own members' welfare and pay, the central "frame" prevents them straying too far from national economic issues. They cannot simply ignore factors which affect the country generally, as can a shop steward at plant level, when there is no central control.

Although the Governments in the Nordic countries do not intervene, as in Holland, in wage determination, their views are not disregarded by the central bargainers on both sides of industry. The Government, particularly in Norway, does make its influence felt but this is not the same as a mandatory incomes policy of direct intervention by the State by the imposition of a ceiling on wages. Where the State has instituted pervasive price controls, they have been, essentially, temporary measures and not, except in Norway, a relatively permanent part of the economic system.

Finally, the central organisations on both sides of industry have a much greater moral and legal control over their members. It is probably an accurate assessment to conclude that "although the final agreement reached in central negotiations is subject to approval and application

by/...

(25) Op cit. Chapter 4. p. 7.

by their constituent members, yet the central organisations themselves must be able to exercise considerable authority. It is for them to attempt to reconcile the competing claims of their constituents".(26) This reconciliation has not always proved successful or acceptable to various interests. But such a reconciliation must always involve a compromise which leaves some discontent. The political and social climate in the Scandanavian countries has been one factor making a compromise economically effective.

The attempt by the British Government in 1969 to introduce legislation to delay strikes in breach of negotiated agreements was, as we have seen, a failure because the attitude of the unions was sufficiently hostile to induce the Government to retreat. Should the attempt be made again? Is it worth the trouble and the friction it engenders? Would such legislation make a material difference to Britain's economic performance by reducing strikes which increase average costs through lower output. These are some of the long-term aspects of an incomes policy, but these aspects directly and indirectly affect the rate of inflation in an economy. They are therefore rightly part of any policy designed to control inflation. But it is exceedingly difficult to change attitudes through legislation, so perhaps an incomes policy incorporating some compulsion to ensure its compliance, is not at present a suitable economic instrument for the United Kingdom, except as a short-term "crisis" measure. The National Board for Prices and Incomes has contended that(27) " the purpose of the (incomes) policy is long-term as well as short-term in two senses: first, it is designed, by helping to contain costs and prices, to overcome the short-term constraint imposed by balance of payments

considerations/.......

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(26) "Incomes in Postwar Europe": Op cit. Chapter 4, p. 6.
(27) "Third General Report": op cit. p. 4. The Board was replying to the contention of the Donovan Commission's Report on Trade Unions and Employers Associations, which stated that "incomes policy is/...

considerations and so restore the objectives of steady growth and high employment; secondly it is designed to act as an essential complement over time to the other weapons of economic policy". No doubt this may be the objective but here there is no mention of compulsion and indeed the Board itself can only operate in terms of the powers given it from time to time by the Government. In fairness to the Board, however, it has more than once emphasised the essentially complementary nature of an incomes policy. But the central problem remain unanswered. What powers of intervention will the Government need to make an incomes policy effective in the United Kingdom and will the end result not be better achieved by some other means? If the Board for Prices and Incomes disappears into obscurity as did its predecessor the National Incomes Commission, what measureswill be required to replace whatever influence it may have had? Possibly there may be a case for retaining the Board or setting up some organisation or body whose objective would be to attempt to influence, over the longer-term, the attitudes within industry and the behaviour of both organised labour and employers and so encourage a better utilisation of the resources of the nation. But if this is really all that any United Kingdom incomes policy is to be, in so far as it is concerned with inflation, such a policy would be purely voluntary. Its value will depend on the degree of influence that it can effectively impose on industry and upon the Government in adopting other economic measures such as fiscal and monetary policies to achieve the same ends. The history of similar bodies in the United Kingdom is most discouraging.

It is/.......

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(27) cont. is concerned with the short-run improvement in the country's economic position and has been revised at fairly frequent intervals".

It is of interest to refer to two views expressed at different periods by C.W. Guillebaud.[28] In 1951 he ended his "lecture" with the following words which are not very dissimilar to those of F.W. Paish in more recent years - "So long as inflation continues", he asserted, "a central policy for wage stabilisation is impossible; as soon as inflation ceases, it will be unnecessary". In 1967, Guillebaud conceded that his statement "needs a good deal of qualification". He considers that the first main clause is "only valid in the sense that any incomes policy directed to keeping the growth of money incomes in line with the growth of aggregate productivity must break down if the degree of inflation is sufficiently great". He contends that the degree was present in 1960-61 and in 1964-65. It is, nevertheless, not clear whether he means that the inflation will be anticipated and wages forced up in advance of price increases with the result that wage increases will more than compensate for the increase in the price level. Possibly he is implying that inflation will result from "cost-push" factors in sectors of the economy where there has been no improvement in productivity. Guillebaud qualifies his second main clause with the view that it requires an unjustifiably great degree of unemployment and excess capacity to keep wages and salaries at the desired limit. He now considers - contrary to the Paishian view - that such a level would be politically unacceptable but does not offer any evidence as to what the level would most likely be.

Those countries such as Holland which have had a more centralised system of collective bargaining for many years and have experienced direct Government intervention or countries such as the Scandanavian nations which have no direct intervention - except for certain price controls

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(28) C.W. GUILLEBAUD. op cit. p. 74.

- but possess a more appropriate institutional framework, do not over the long-term appear to have coped any better with secular inflation than West Germany and Italy which have no such incomes policy and whose climate of opinion and institutional framework is in many respects different. We shall examine in the next chapter the experience of Holland, a smaller and relatively more closely-knit nation than Great Britain to see what lessons she can teach such countries as the United Kingdom whose growth rate has for many years been so disappointing. But it must be stressed again that a policy which is suitable for one country may be both inappropriate and unacceptable in another. The relatively successful management of the Dutch incomes policy in the immediate post-war years was almost certainly due to factors which were not present when the United Kingdom attempted to introduce hers.

If the British experience can be summed up at all, perhaps all that we may claim ~~us~~ is that it had some short-term beneficial effects which cannot be measured with any precision. In the long-term the answer is even more uncertain. If the incomes policy as a whole and the influence of the Board for Prices and Incomes in particular, have succeeded in changing sttitudes, dismantling restrictive practices and allaying long-standing fears of redundancy and unemployment and effectively promote the more efficient utilisation of all resources in the country, a great deal will have been achieved. But the words of the Board in 1969 sounded a sombre note which subsequent events have not contradicted. "From the long-term point of view", observed the Board, "..... expectations with respect to the growth of incomes had increased and were increasing independantly of any policies ....Whatever the cause, they may make the successful implementation of the (incomes) policy, in terms

of/.......

of modifying the rate of growth in money earnings in relation to the rate of growth in productivity that much more difficult, though that much more necessary".[29] If the Government had been seen to have taken these comments more seriously then, the ensuing wage and price spiral which gathered force later in 1969 and in the following year, might to some extent have been avoided, if not by another "freeze", then by alternative measures.

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(29) "Fourth General Report": p. 4.

CHAPTER VIII:

The experience of the Netherlands in the imposition of a comprehensive prices and incomes policy immediately after the Second World War serves as a valuable illustration of what such a policy can achieve both in the short-term and in the long-term in a particular institutional environment and under a climate of co-operation from all sides. A national policy such as Holland's, as we have indicated before, cannot necessarily be transplanted successfully in other countries, in any of the particular variations that it has assumed since its inception. Nor may some portions of it be the best, or, even, appropriate substitutes for other economic instruments such as fiscal and monetary policies which might have served the country better in some circumstances. Indeed, Professor J. Pen has remarked that "in many respects Dutch wage policy is an improbable affair"(1).

At the end of the War, the very severe damage which had been inflicted on the Netherlands made drastic action by the State essential to achieve a rapid economic recovery. The Dutch had, indeed, to re-build a very substantial part of their capital stock. The Government, unfortunately, did not merely have to supervise a change over from war-time to peace-time production. Inflation was a very real threat, particularly as exports comprised a very large portion of total output. The Dutch authorities considered that only an extensive direct intervention into the price and wage determination process would be sufficiently effective in these circumstances to ensure recovery. The pre-war system of collective bargaining was not considered suitable in the prevailing conditions.

In 1945/...

(1) J. PEN: "The Strange Adventures of Dutch Wage Policy" British Journal of Industrial Relations. 1963. p. 318.

In 1945 the Foundation of Labour was formed and consisted of representatives from trade unions and from employers' organisations. "The interests of the Foundation" noted B.C. Roberts[2], "embrace wages, social insurance, health and safety, productivity, technical training and employment. It does not include under its jurisdiction the broad issues of economic policy, though it cannot ignore factors that will inevitably affect the levels of employment, wages and prices".

The Foundation did not have legal powers and so it was, in effect, no more than a voluntary organisation. It was under the supervision of the Foundation nevertheless that "the major pay negotiations take place between the trade union federations and central enployers' organisations .....(and) those central negotiations lead to a frame agreement or guidelines to be followed in subsequent branch and local bargaining."[3]

The direct intervention in the wage fixing process was through the creation of a Board of State Mediators, which although composed of independent experts was responsible to the Minister of Social Affairs. Although the Foundation of Labour was a voluntary body, the Board had the statutory duty imposed on it to consult the Foundation before making a decision in respect of matters normally within the sphere of interest of the Foundation itself. Accordingly, the Board of State Mediators had the power after consultation with the Foundation to prevent wage agreements from being implemented if they appeared to be in contravention of the existing criteria for wage increases prevailing from time to time.[4]

Pen has/....

(2) B.C. ROBERTS: "National Wages Policy in War and Peace". pp 118-119.

(3) "INCOMES IN POST-WAR EUROPE", 1967. U.N. Publication Chapter 4, p. 2.

Pen[4] has stated that "it is too crude to say that wages were simply fixed by the Government; the interplay between the two agencies (the Board and the Foundation) was much more subtle."

It is, nevertheless, important to view the Foundation as well as the Board as part of the whole national planning mechanism in the Netherlands and not as operating separately or independently of the economic planning structure and econometric models developed and applied by the Government.

In 1950 a further body was established. This was the Social and Economic Council. This organisation was composed of representatives of the unions and employers and, in addition, contained persons nominated by the State with a view to ensuring that the general interests of the public were not neglected. The Council was to some extent under the guidance of the Central Planning Bureau, and in practice it has proved to be of value in assisting both sides of industry in coming to an agreement which satisfies the economic criteria laid down to deal with specific economic situations. The Council, however, does not take any direct part in the negotiations between unions and management. Its activities to some extent overlap with other bodies but in the earlier years of its existence there was no undue friction because of this.

Before examining the development and effects of the Dutch incomes policy it is necessary to say something of the institutional and social conditions within which it had to operate in the more successful period immediately after the War. The background against which the policy was administered was almost certainly one of the principal reasons for its success.

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(4) J. PEN: "Income Policy in the Netherlands 1959-1963". Scottish Journal of Political Economy. November 1964. p. 183.

It has been suggested that Holland provided a "laboratory test, launched in as ideal political and social conditions as are likely to be found anywhere"(5). This statement implies that if a comprehensive incomes policy is likely to be effective in securing control over the rate of inflation, no better case-study could be found than the experience of the Netherlands because of the political and social climate in which it was instituted. Hennessy remarks that "during the war employers and union leaders, patriotically anxious to sabotage the enemy occupation, had become accustomed to work together in secret conferences which created goodwill to continue to co-operate in the tasks of peace". We have already seen that in the United Kingdom the long-standing suspicion and deep distrust between employers and work-people and between large sections of the Labour Party and the Conservatives made the institution of an incomes policy such a daunting undertaking. This, together with the inability of the Trades Union Congress in Britain to acquire effective authority over its constituent members made the implementation of a voluntary incomes policy virtually impossible and a compulsory incomes policy exceedingly difficult to achieve except during the "freeze" in 1966 and 1967. Hennessy adds that "the devastation which Holland had suffered (during the War) had made everyone believe that a common and national effort was needed for recovery and that extensive regulation of the economy was indispensible. The election of a Socialist Government was hailed as ushering in a new era of planning and social justice".

As the incomes policy formed a part of the whole national planning model in the Netherlands economy it was an obvious means for achieving not merely control over the rate of inflation, but also to ensure that

social /.....

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(5) JOSSELYN HENNESSY. "Incomes Policies in Europe". Part II, 1964, p. 48.

social justice was seen to be a fundamental element of the incomes policy. In so far as the various organisations and the State were directly and indirectly associated with the determination of wages and prices this was viewed by many as the best method of attaining social justice. This attitude was very strongly held as it was widely felt that social justice - even if such a concept cannot be defined with precision - was not always achieved when wage negotiation was left entirely to the relative power of each side of industry as determined by market forces, the size of strike funds, the labour supply in particular industries and other purely "economic" forces at any moment in time.

The legislation introduced after the War to provide for wage control and the necessity for official approval of collective agreements was the "Besluit Arbeidsverhoudingen" of October 1945. This Extraordinary Decree did not include all groups of employees. The system of wage regulation introduced by the Decree did not extend to the civil service, teachers, domestic servants nor the salaries of executives and staff employees. Groups which were not covered by this legislation were not necessarily free of central control as their wages could be fixed by the central agency, namely the Board of State Mediators. This applied in particular where there were no collective agreements in existence.

The Dutch planning mechanism and the criteria for wage increases have been based largely on exceedingly complicated econometric models, which are almost incomprehensible to the general public. Nevertheless, as the public did trust the Government, at least in the early years of its implementation and had confidence in the independent experts and moreover, recognised the need for considerable direct intervention by the State, there was much less likelihood of friction and instransigence.

Until/....

Until the 1960s strikes were an unusual occurrence. Some unions had for long advocated that jobs should be paid according to certain social criteria rather than purely according to market demand or decided by monopolistic power. This appealing concept lay behind the very extensive job evaluation investigations carried out in Holland in order to determine an acceptable rate for the job, irrespective of whether a particular industry could pay more because of its greater productivity or profitability. As R.J. Ball (6) has remarked, job evaluation with the underlying principal of equal pay for equal work and implying in effect that the value of work is intrinsic to the work done gives effect to the concept that pay "should not be governed by the level of demand derived from the value of the product in the open market. Social justice rather than market forces determine the rate for the job".

In the years immediately following the end of the War and in the early years of the next decade wage increases were related to the increase in the cost of living, so that in the period real incomes did not show a rise. (7) The United Nations survey "Incomes in Postwar Europe" (8) claimed that "for nearly ten years after liberation, the central pay settlement took the form of uniform and modest percentage increases for all branches and occupations, justified only by increases in the cost of living/.......

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(6) R.J. BALL - "Inflation and the Theory of Money" p. 297.

(7) It has been argued by some economists that in certain countries inflation has been accentuated by tying wage agreements or wage increases to the cost of living index. This is because the index may, for example, show a rise due to a temporary increase in imported commodity prices. If this increase then becomes added to wage rates it will tend to perpetuate the increase in prices because of higher wage costs. This is, probably, only true where increases in wages are adjusted monthly or at very frequent intervals. Italy has been cited as an example. In Holland the cost of living index was not specifically included in wage agreements.

(8) Op cit. Chapter 4. p. 3.

living (themselves due mainly to import prices and other independant forces)". This survey considers that by 1954 Holland was about the only Western European country "in which there had been no increase in real hourly wage earnings since 1948". Such a conclusion may be a somewhat bleak assessment. Other economists have suggested that in the late 1940s the relaxation of physical controls and the disappearance of consumer goods shortages had given a wider choice and so an increase in real income. However this real increase was probably reduced in the first few years of the following decade as a result of the greatly increased price of imports caused by the Korean War so that prices rose above the increases in wages, thereby reducing real income.

The Dutch authorities in calculating pay scales for the establishment of the complex income determination system decided to retain, by and large, pre-existing pay differentials. Having set wage rates for unskilled workers, a differential of 10 per cent was established between these workers and semi-skilled employees and a further 10 per cent between semi-skilled and skilled. There was a series of adjustments during the period from 1945 to 1947. As a result, although skilled workers still received 20% above unskilled workers, semi-skilled received about 7% to 8% more than unskilled. The differentials remained relatively constant during the ensuing twelve years. The methods used for job evaluation were carried out exhaustively and both maximum and minimum wage rates were fixed. Infringements of these prescribed rates made the offenders subject to prosecution. Wage differentials are, as we know, often of relatively long-standing existence and even where technological changes and market and social forces tend to alter them, they can often be perpetuated by the attitudes held by union members.

The/......

The Dutch incomes policy tended to perpetuate the existing differentials although whether the "social justice" element in the fixing of wages and prices and the retention of differentials was economically sound is a matter of controversy. It seems clear that unless the rates appeared to the majority of the population to be equitable their implementation would probably have been impossible in peacetime conditions, even in the relatively helpful social climate of the Netherlands immediately after the War.

The Dutch economy showed a very substantial recovery by 1955. The problems and disagreements which, however, had not been sufficiently strong to intrude damagingly into the economy, now began to emerge with considerable strength. Perhaps the most important was the growth of the feeling that the direct intervention by the State into the fixing of wages was no longer essential in view of the relatively healthy state of the economy. This view was shared both by employers and by some, though certainly not all, unions. The Socialist unions still favoured Government control. However, there arose during this period a general discontent with and opposition to the principle of equal pay for equal work. Employees in the more productive industries felt that they should receive some additional benefit in view of the increased productivity for which they regarded themselves as having been, in part, responsible. Accordingly, the question of economic criteria for wage rises began to make itself felt much more strongly and the concept of "solidarity" was naturally less appealing to employees in growth-oriented and productivity-minded enterprises.

Initially the Government tried to resist this demand for greater weight to be attached to the forces of the open market in deciding upon wage increases. As the economy expanded and the demand for labour increased, there was the strong incentive for employers to pay "black"

wages/.....

wages and, indeed, wage drift was very difficult to control. The Government realised that it was no longer feasible to retain the strict criteria over wages that it had maintained up until then. The period of growing unrest, dissatisfaction and resentment among both employers and labour made it seem possible that the whole pay structure was in danger of collapsing. In particular, some workers demanded greater differential increases and although this was opposed by the Socialist unions one economist has since remarked that their efforts to enforce "solidarity" were "as effective as Canute's to the rising tide".(9) Thus, as the economic position made for a build up of excess demand the policy of "wage co-ordination", started to disintegrate under the economic and political pressures against which it tried vainly to fight.

The Dutch Government had, however, been moving very slowly towards the recognition of wage increases in terms of productivity gains in particular industries from 1956. In that year pressure for wage increases had mounted as there had been two years of rapid economic expansion. The Government, like many Governments in a similar predicament, was fearful of the onset of inflation as unemployment had declined from 3.5% in 1952 to an average of 1.3% in 1955. It was, moreover, to decline further to 0.9% in 1956. The unions argued that their share of wages in the national income had declined. The Social and Economic Council, which, it will be recalled, was set up in 1950, issued a report after it had instituted an enquiry. It conceded that wage rates had lagged but that earnings had not. The Government at length consented to an across-the-board increase of 3% in basic wage rates. They also agreed that an additional increase of up to 6% could be made by individual industries. This additional maximum of 6% was subject to the condition that

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(9) JOSSLEYN HENNESSY: op cit. p. 49.

not more than 3% of it should be passed on in increased prices. Furthermore, the initial overall basic increase of 3% was not to be passed on in prices, profits having to bear the burden of the increased cost. The real significance of the 6% allowance for individual industries was, of course, its relationship to profits and in particular to productivity. Thus there was a tacit admission by the Government, that the concept of job evaluation which was not influenced by market forces was to be modified in so far as increased productivity permitted larger increases in some industries than in others. As B.C. Roberts has observed (10) "the abstract conception of social justice which had been at the heart of the attempt to co-ordinate wages scientifically had evidently not provided workers or employers with the satisfaction anticipated". Although the 6% was intended to be the maximum at the time, it is clear that most industries agreed to the full percentage, irrespective of relative productivity, mainly because the demand for labour was very high. The only major exception was in agriculture. Unions, in fact, tended to press for the maximum increase as a matter of course. This approach was similar to that adopted by the unions in Great Britain in 1968, who had regarded the 3½% maximum laid down by the British Government as a minimum. In 1957 and 1958 there was a recession in the Netherlands which alleviated the labour shortage. In 1959 as the economy expanded the Government started to look more closely at the problem of wage rates and differentials.

In 1959 a new Government was returned to power composed of the clerical and liberal parties and without socialist members. With the departure of the Socialists from the Government the parties in power laid down new criteria for increases in pay which were directly related to

productivity/...

(10) B.C. ROBERTS: op cit p. 117.

productivity increases. There was now explicit, and not merely implicit, recognition by the State of the need to allow market forces a more effective, but by no means an exclusive, say in the determination of wage rates. Unfortunately, the Government's criteria for determining productivity increases was very far from clear. There remained therefore a lot of dissatisfaction and not a little uncertainty and confusion in the various sectors of the economy as well as between employers and organised labour. This lack of clarity was, to a limited extent, rectified by the Government in 1960 with a revised series of instructions, but there was still great difficulty in deciding not only on an adequate and acceptable measure of industrial productivity but also on an acceptable base date on which future productivity would be calculated.

In 1963 the new system was eventually implemented, not, however, without a good deal of animosity being engendered because of the frustration felt within industry at the extent of Government intervention still prevailing.(11) Although some industries and firms were apprehensive of what greater economic freedom might mean in the way of added union pressure for sustaining higher pay claims, some of the largest firms, appear to have welcomed the lessening of State intervention and much preferred to negotiate with greater freedom with organised labour at industry and even plant level.

The most significant change in the new system introduced in 1963 was that the Foundation of Labour and not the Board of Mediators should thenceforth approve branch agreements. This meant that "the internal co-ordination, and the Government's authority to approve or disapprove agreements would normally be exercised jointly by the central union and employers/....

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(11) J. PEN remarked that by 1962 "faith in the Government had disappeared .....employers and workers wished to be free of Government intervention". "The Strange Adventures of Dutch Wage Policy" Op cit. p. 326.

employers organisations in the Foundation of Labour instead of by the official board ..... which had previously performed this function."[12]

Despite the change in authority, reserve powers were retained by the Board so that agreements which were thought not to be in the public interest could be prevented from being implemented. The State could also authorise a temporary "freeze" on wages should it regard the economic situation sufficiently serious to justify this direct intervention. This type of "freeze" was also adopted in other countries such as Denmark and France in 1963 and 1964 (not to mention the United Kingdom in 1966 and 1967) but in these two Continental countries there was and is no formal "incomes policy" of either a voluntary or compulsory nature.

The acceptance by the Foundation of Labour of the responsibility for approving agreements was not without its disadvantages. From then on union leaders could not escape criticism by union members, by absolving themselves from responsibility for unpopular wage decisions. Until the transfer of authority the Board of Mediators could always be blamed if union members did not receive what they thought was their due. The Board had accepted this responsibility and so the Foundation of Labour could always pass the blame, if it so wished, to the Board. It could do so no longer. The Foundation had now to face the strong criticism and pressures that built up within industry and it had itself to find acceptable solutions to these problems. The Foundation could not, in practice, act with the detachment and independance notable in the decisions of the Board. Life for the Foundation became much more difficult and the tensions within it more evident.

It was/....

(12) "Incomes in Postwar Europe". op cit. Chapter 4 p. 4.

It was unfortunate for the Dutch economy that the new system of wage determination should have taken place prior to an increasingly serious shortage of labour. The result was that the anticipated increases proved to be far less than those that occurred. The pressure of demand made it impossible for the Government or the Foundation to prevent increases well above those they had thought acceptable. What has been described as a "wage explosion" took place in 1964 and 1965. Employers were again prepared to pay "black" wages as they had on previous occasions when there had been a serious labour shortage. Accordingly both wage rates and earnings rose substantially and price stability could not be maintained. In 1966, the Government, extremely concerned about the escalation of prices and wages, for a short while took over from the Foundation the power to approve or disapprove agreements by transferring these powers to the Board.

The Social and Economic Council which was at this juncture called upon to report on the need for revision of the wage determination process thought that the State should still retain authority for approving collectively bargained agreements. Nevertheless, it was clear that there was a substantial minority within the Council that was of the opinion that despite the ultimate authority of the Government for the determination of wage policy, direct intervention should be resorted to only in extreme situations in times of major economic crisis.

We have already quoted the views of B.C. Roberts in respect of the experience of the Netherlands but it is again worth referring to him as he expressed cogently and succinctly in 1957 (12 *) views which would appear to have been largely justified by events in the subsequent ten years. He had wisely observed that "the essential lesson to be learned

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(12*) B.C. ROBERTS. op cit p. 131.

from the experience of the Netherlands is not that inflation cannot be prevented by wage controls .....(it can) ..... but in a democratic society it is impossible to isolate the instruments of wage determination from the pressures generated by the interplay of economic forces. In these circumstances", claims Roberts, "stability can only be achieved by the resolute and persistent control of the factors which lead so easily to an over-rapid expansion of effective demand ....If the check (to inflation) is to be converted into a stable trend permanent reliance cannot be placed on wage controls, it must be placed on fiscal and monetary policies that will maintain a level of effective demand that does not constantly induce wages to rise above the level that would permit price stability".

The O.E.C.D.(13) considered the "wage explosion" in a survey of the Netherlands in 1966. It pointed out that various explanations had been suggested for the rapid rise in wages in 1963 and 1964. These were, "integration within the European Economic Community where (at least in France and Germany) real wages were higher; the possible under-valuation of the florin (and) the conditions of over-full employment". The survey suggested that the evidence favouring the integration within the E.E.C. and the possible under-valuation of the florin was not persuasive. It asserts that "the large differences in real wages as between countries (and even as between regions of the same country) do not lead to automatic 'catching-up' processes. They are important only if they result in large-scale movements of labour towards the country where real earnings are higher .... The creation of the E.E.C., however, has altered the legal but not the effective conditions of labour movements". Indeed, there has been a "net/...

(13) O.E.C.D. "Economic Surveys. Netherlands" July 1966 pp 8-16.

"net immigration of about 10,000 from 1960 onwards" as compared to a net emigration of between 10,000 and 20,000 previously. Accordingly, the increase in the supply of labour would be expected to result in a moderation in the rate of wage increase. The Survey agrees that the wage explosion of 1963 and 1964 "took place in conditions of over-full employment" but added that "over-full employment was not a novel phenomenon" in the Netherlands and had existed in the period from 1960 to 1963. Why, then, did the wage explosion lag by about four years? The Survey does not deny that there was a connection "between over-full employment and wage development" but suggests that "the timing and the dimensions of the 1963-64 increases probably depended on factors which lie beyond the scope of economic analysis properly speaking". All the same these factors are most important because they may point to fundamental reasons why an incomes policy may work reasonably successfully in a country during particular periods and why it may be so difficult to institute such policies in other countries. Apart from the factor that employers wanted to "eliminate or limit" 'black wages' by paying higher wage rates, employers "may also have tired of detailed discussion and intervention involved in previous policies. It may also be", continues the Survey, "that in the employers' organisations, the dominant rôle is played by the largest firms, who could more easily bear large increases. The change in attitude of the unions, from relative moderation and acceptance of the centrally established 'norms' or 'guidelines' up to 1962 to massive demands in 1963 and 1964, may have reflected tensions between rank and file and union leadership, which eventually forced the leaders to change their attitudes". In short,

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the social climate may have changed so much as to make the incomes policy much more difficult to pursue. The new system instituted in 1963 was itself primarily a result of the change in the attitudes and behaviour of industry.(14) The O.E.C.D. Survey in 1967 noted that the wage explosion resulted in average pay increases per worker of 15 per cent in 1964 and another 11 per cent in 1965. "The Government had accepted the freer wage policy to ease the growing tensions on the labour market".

We have already mentioned that in 1966, the Government reverted to its former policy whereby the Board of Mediators hadfull authority "to approve, delay, suspend and freeze wage agreements", because a moderation in the rate of wage increase was not evident. Control of wages continued in 1967. However, at the end of 1967 a formal agreement was reached whereby the system of prior approval of wage agreements would be abolished as from the beginning of the following year. The Minister of Labour retained the power "to invalidate freely negotiated collective agreements if they were threatening the equilibrium of the economy".(15) A new body of five independant experts was appointed to advise the Minister. The system of prior approval of collective agreements by the Foundation of Labour "came practically to an end in December 1967". It will be recalled that the system instituted in 1963 replaced the Board of Mediators with Foundation of Labour as the body responsible for approving agreements.(16) The O.E.C.D. Survey said that "it is also hoped that the regained freedom in wage negotiation will avoid the bickering and bad feelings that beset the central wage discussion inside the Foundation of Labour".

The freer system of wage negotiation which operated during 1968 and 1969/.....

(14) O.E.C.D. "Economic Surveys. The Netherlands" April 1967 p. 39
(15) O.E.C.D. "Economic Surveys. The Netherlands" May 1968 pp31&33
(16) O.E.C.D. May 1968 op cit. p. 33.

1969, however, was seen as a transitional period pending agreement between the Government and both sides of industry on future wage policy. A bill was introduced in Parliament in September 1968 providing for Government intervention, but it was met with "heavy parliamentary and public opposition".(17) The Government had sought the power, if it considered that wage contracts were contrary to the national interest to:-

"(i) invalidate wage agreements

(ii) to decree a general wage freeze, and

(iii) as a last resort to introduce for a maximum period of one year the earlier system of prior government approval of wage agreements". (18)

There was provision for prior consultation with various bodies before certain powers were exercised and in the case of (iii) parliamentary ratification of action taken by the Minister of Social Affairs was required within three months.

In view of the opposition to the Bill part (iii) was dropped and part (i) was amended to include circumstances when it could not be invoked. The amended Bill was finally approved by Parliament in February 1970. Nevertheless the O.E.C.D. stated out that "in protest the two largest unions have withdrawn from all further negotiations at national level with employers associations and the Government, in so far as the latter might derive from such discussions any norms for further wage trends".(19) These unions were not prepared to accept the amended Bill which still gave the Government the power to interfere with the terms and conditions of individual agreements.

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(17) (18) O.E.C.D. "Economic Surveys. The Netherlands" April 1970 pp 28-31

(19) Op cit. April, 1970.

The question may now be asked whether the Government's incomes policy was a success. This is as difficult a question to answer as was that of evaluating the British experience because, as we have repeatedly stressed, the success of any mandatory incomes policy will depend to the extent on which it is complemented by fiscal and monetary policies and on the relative importance attached to the various objectives. Holland, which exports approximately half of its national product has always been acutely conscious of the urgency of the need to take action when there appears to be a threat to her competitiveness in international trade. The incomes policy may well have been a more appropriate economic measure to help control inflation in the longer-term than it has been in the United Kingdom. Holland's political climate, its institutions and especially the fact that it is a relatively small country certainly helped. So too did the fact that it was a much more closely-knit community. Would greater reliance on monetary policy have been preferable? No unequivocal answer is available. The economic effects of monetary policy are today often far from clear and much less was known about them twenty-five years ago. The crucial problem of leads and lags and timing bedevils the most sophisticated "monetary managers" in highly industrialised countries. We do not know what level of unemployment in the Netherlands, in comparison with other countries, would be needed for maintaining price stability. Therefore, the direct intervention may have been the most suitable means of controlling wage and price changes.

The O.E.E.C. Report in 1961[20] takes a somewhat more favourable view of the Dutch policy than economists who find this type of direct State intervention economically harmful or irrelevant. The O.E.E.C. Report/...

(20) "The Problem of Rising Prices". Op. cit.

Report remarks that if the political climate is congenial, co-operation between labour and employers has been shown to be possbile to prevent inflation, subject to the proviso that "conditions of extreme excess demand are not allowed to emerge". Moreover, the Report was right to point out that there was at that time - and the same would appear to apply today, nearly ten years later - the much more difficult calculation of how deviations from average increases permitted "were to be divided within the sphere of co-operation". In other words, how were the increases to be shared out? This difficulty is highlighted in so far as the Government or the Foundation of Labour has to consider prevailing market conditions, political pressures, concepts of social justice, short-term and long-term effects on the supply of different types of labour, the supply of capital, the encouragement of innovation and enterprise and many other factors before deciding whether to permit the implementation of a particular agreement. In short, can a really pervasive mandatory incomes policy ever be successfully administered except in critical economic conditions when people may be willing to forget their particular interests for the common good? As yet there is little assurance that it can. The extensive human resources, although admittedly difficult to quantify, which are needed to institute and apply a comprehensive incomes policy may be far more usefully employed in more productive activities.

It is necessary to consider the Dutch approach to profits and prices as these are essential elements in an incomes policy and their inclusion in the Dutch incomes policy contributed to its success in the immediate post-war period.

It had been realised by the political leaders in the Netherlands that despite the relatively high degree of goodwill existing between organised labour and employers, an incomes policy was not a feasible political

proposition/...

proposition unless profits and prices were brought within its ambit, irrespective of their economic significance. It was important, if the goodwill of labour were to be retained, that an incomes policy include non-wage incomes. Economists realised the problems inherent in trying to control profits by other than fiscal methods. Some of these problems we have considered elsewhere, such as the effect on entrepreneurial incentive and on costs if profits were to be pegged. We have pointed out already that where profits are pegged the competition essential in a basically free enterprise economy would be eroded and it is quite possible to envisage circumstances where inefficient firms would be able to remain in business. In conditions of excess demand and pegged profit margins there is naturally much less incentive for either an efficient or an inefficient firm to reduce its costs. In the case of an economy such as that of Holland which has to face international competition in order to survive, this in itself would undoubtedly provide not only the need for industrial efficiency but also the incentive to remain competitive in order to remain in business at all.

Profits in the Netherlands were, of course, subject to tax, but, other than by fiscal means, the only really effective control of profits was through price controls. In practice, the control of prices has been operated, in the main "by negotiation and voluntary agreement between the Government and producers, although .....(the) Government (has) the Statutory power to fix maximum prices if negotiations should fail".(21)

In the Netherlands these powers are comprehensive. As the Dutch spend approximately half their national income on imports, it is very difficult for the State to prevent price increases where they are caused

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(21) "Incomes in Postwar Europe". Chapter 4. p. 10.

by the rise in price of imported raw materials or capital goods. Especially during the Korean war period when prices of primary commodities rose steeply it was impossible in many instances to prevent domestic prices rising as a result. There was, nevertheless, co-operation between the Government and producers in fixing prices. Producers were required to inform the Minister of Economic Affairs of all price increases of both goods and services. This notification was to be accompanied by the reasom for the increase. In the case of some basic commodities, such a milk, bread and margarine, a price increase had to be notified to the Department in advance. This list became much smaller than in the critical period following the War and is part of the attempt by industry to free itself from direct state intervention in price fixing as well as in wage determination. There is still considerable control over rural and urban rents, but much of this stems from pre-war legislation.

It is important to remember that the Government has reserve powers and has on occasions used them when excess demand generally or the pressure of wage costs arising from wage increases, in particular, have made themselves felt in the level of prices. In 1963 and 1964 these reserve powers were used with effect to stop price increases. In 1966 the Government, again concerned about the balance of payments, authorised a blanket price "freeze" unless the price increases could be shown not to stem from rises in wage costs, but were caused through the higher prices of imported goods.

At the end of 1966 the producers, wholesalers and retailers agreed to continue to co-operate with the Government in the following year with regard to price policy. The Government retained the right to control

price/....

price increases if it regarded them as being unjustified. In 1968 and during the early months of 1969 the Government pursued a more active price policy as prices were showing significant increases. This policy did not achieve the desired results so a price "freeze" was instituted in April. Relative price stability ensued and there was a relaxation of the "freeze" in September. However, these emergency "freezes" are not themselves cures for an inflationary spiral. The O.E.C.D.[(22)] remarked that "it would indeed be desirable that (employers and employees) draw up some stabilisation 'plan' .... and that this should not be regarded as an emergency step to be taken only after an inflationary spiral has begun."

How has Holland fared in comparison with other countries as regards consumer prices? Using an index with a 1958 base the figures below reflect the change in consumer prices from 1951 to 1966 in West Germany, Sweden, the United Kingdom and the United States as well as Holland.

CONSUMER PRICE INDEX 1958 = 100

	Holland	W. Germany	Sweden	United Kingdom	United States.
1951	86	92	76	79	89
1966	129	122	134	124	113

West Germany without an incomes policy, has done better than Holland. So has the United States. Sweden on the other hand has done somewhat worse with a relatively centralised system of collective bargaining and a considerable measure of control by central industrial organisations over their members. The price increase in the United Kingdom has been greater since 1958 than before that year, despite the attempts at a voluntary incomes policy by the Conservative administration.

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(22) Op cit. April, 1970 p. 41.

The table below sets out in more detail the rise in domestic output prices in nine Western European Countries from 1953 to 1964 together with the percentage of this rise attributed to incomes from employment. The figures should be viewed in the light of the weight of the component, income from employment in total domestic output:-

Country	Domestic Output Price Rise.	% Contribution to Price Rise. Income from Employment Total.	of which employers' contribution to social security.	The weights of the component of income from employment in total domestic output in 1953 and 1964 g.d.p = 100 Total	of which employers' contribution to social security.
Period 1953-58 Netherlands	21.7	71.2	9.9	1953:43.3	5.8
Period 1958-64	28.3	74.2	13.8	1964: 53.2	7.9
Norway	19.9	59.1	2.5	47.0	0.8
	19. 0	56.3	13.2	50.0	2.7
Sweden	18.1	62.9	-	59.0	-
	25.4	77.9	-	62.8	-
Denmark	14.5	52.9	0.3	46.1	0.3
	34.7	52.1	-	48.2	-
United Kingdom	21.1	69.3	7.3	58.0	3.5
	16.9	59.5	6.5	59.9	4.5
West Germany	12.0	67.0	13.0	44.8	4.4
	22.4	59.9	4.0	49.3	5.1
France	28.4	53.5	8.5	44.2	8.4
	38.0	59.6	16.0	48.3	10.0
Italy	12.3	54.3	-	39.4	-
	29.8	71.3	-	47.3	-
Austria	17.8	47.9	12.1	46.8	5.3
	26.6	55.4	10.6	48.8	7.1

What conclusions may be drawn from these statistics? Firstly, although Holland had the most comprehesive incomes policy of any mixed industrial economy, domestic output prices in the first period from 1953 to 1958 rose more rapidly than in Sweden, Norway, Denmark, West Germany, Austria and Italy and even the United Kingdom. In the second period from 1958 to 1964 prices rose more steeply than in Norway, Sweden, the United Kingdom and West Germany, but less so than in France, Italy and Denmark.

From these figures is it fair to say that the Dutch wage policy achieved more than the relatively greater reliance placed on fiscal and monetary policies by other countries? The facts do not seem to be conclusive or even particularly persuasive when viewed from the longer-term aspect in evaluating the success of the incomes policy. The figures, however, must be viewed with some caution as the authority quoting[23] them admits that the measures for computing them are not the same in each country. However they are not likely to be sufficiently inaccurate to justify disregarding them.

What of labour productivity? Here again the table on the following page, taken from the same source is by no means conclusive and it is necessary to stress too that the computation of the productivity of labour and capital is subject to a good deal of controversy.

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(23) "Incomes in Postwar Europe". op cit. Chapter 2.

Changes in output and unit costs for various cost-components in selected Western European countries, 1953 to 1964.

Country	Domestic output a		Cost per unit of output			Income per unit of input		Inputs		Productivity	
	Volume	Prices	Labour	Capital	Indirect taxes (net)	Labour Earnings	Gross Capital return.	Labour	Capital	Labour	Capital.
Austria	184.7	144.4	131.2	192.2	172.2	235.5	- -	103.9	- -	177.8	- -
Belgium	151.8	122.4	128.1	107.2	152.1	180.5	115.3	106.6	139	142.4	109.2
France	170.8	166.4	164.3	165.7	176.7	272.1	188.7	103.2	150	165.6	113.9
Western Germany	209.6	134.4	139.0	131.2	122.9	220.9	157.9	126.1	194	166.3	108.1
Italy	183.8	142.1	149.8	128.2	156.6	264.0	159.0	101.1	139	181.8	132.2
Netherlands	168.4	150.0	171.1	120.4	124.5	243.9	121.4	118.1	167	142.6	100.8
Norway	155.7	138.9	133.5	147.1	157.6	203.9	140.3	103.6	157	150.3	99.2
Sweden	159.0	143.5	141.9	123.1	211.9	206.7	- -	109.1	--	145.6	- -
United Kingdom	139.5	138.0	144.7	121.1	141.1	188.2	114.5	107.4	147	129.9	94.9

a: At market prices

Index for 1964, 1953 = 100

In concluding the discussion of the development of the incomes policy in the Netherlands it is necessary to stress that wage and price stability must be seen in the context of Dutch economic policy as a whole. Murray Edelman and R.W. Flemming[(24)] go as far as claiming that "it cannot be overemphasised, that wage and price stability as such have not been a major objective of Dutch economic policy. As a matter of fact," they assert, "leading economists in the Netherlands argue that their system has little to do with wage inflation or cost-push theory. The wage policy evolved not from theorising, but from the desparate postwar economic situation and the sheer necessity for co-operation on the part of the interest groups ..... Thus wage policy was conceived and developed within the framework of multiple objectives, including not only wage-price stability, but also and much more important, rapid economic growth, full employment, balance of payments quilibrium, equitable distribution of incomes, industrial peace in a framework of industrial democracy, and economic planning to ensure an orderly, co-ordinated development of all factors contributing to national economic policy". Edelman and Flemming observe, however, that "it is extremely difficult to measure the degree to which these various objectives have been achieved".

The development of the incomes policy of the Netherlands from 1970 is difficult to predict. The stresses and strains affecting the policy are significant and may become more intense. Much greater freedom in wage negotiation is now accepted by the Government. It is possible that the incomes policy will move further towards the policies of the Scandinavian countries and, in particular, Sweden, but it is likely that the Dutch Government will want to retain its reserve powers for a considerable time to come. The Dutch policy had,

of course/....

(24) MURRAY EDELMAN and R.W. FLEMING: "The Politics of Wage Price Decisions. A Four-Country Analysis". p. 273.

CHAPTER IX

It would be satisfying to conclude a survey of income policies with some persuasive arguments that they were worth the trouble they involved instituting and applying them. Unfortunately, no such evaluation seems to be justified, except in so far as the policies are designed, purely as relatively short-run measures for managing an economy in times of crisis and emergency. However, it is surely right to question whether a short-term "freeze" or similar restraint on prices and incomes may properly be called an "incomes policy". If a "freeze" is included within the concept of an incomes policy, there may be sound economic reasons for its imposition, if it is essential to secure an immediate and effective control over prices and incomes. Despite the disadvantages of extensive government intervention, a "freeze" is quick-acting. During the period of its imposition it may be possible to set in motion other economic measures which, although acting far more slowly, serve in the longer-term to change the structural and institutional conditions which encourage and perpetuate inflation. The "freeze", accordingly, may assist in providing an appropriate temporary respite, during which other factors may be allowed to influence the economy, by changing social attitudes, alleviating shortages, and promoting a more efficient use of the resources of the country.

Where an inflation is diagnosed as primarily of a "cost-push" nature, sustained by "administered" prices in key industries and the monopoly power of organised labour, an incomes policy may be of greater assistance in the short-run, in controlling the rate of inflation, than other policies, such as a tighter control of the money supply or severe fiscal measures. An incomes policy may be able to avoid the level of unemployment and the margin of spare capacity that the application of alternative policies may require. Miss Anne Romanis has observed that "in practice ... the inducement to adopt an incomes policy is stronger in some economies than in others. The inducement is

(1) MISS ANNE ROMANIS: "Cost Inflation, Incomes Policy in Industrial Countries". International Monetary Fund. Staff Papers March 1967 p 204.

greatest", she considers, "where relative price stability is needed to facilitate expansion of employment ..... or to improve a critical balance of payments".

However, if the direct intervention by the State in the determination of prices and incomes encourages attitudes that make institutional and other changes even harder to achieve, there is little or nothing to justify it. The members of a community must, as a whole, freely co-operate, if the policy is to have any success. We cannot but agree with Professor J. Pen,(2) who remarks that an "incomes policy must be accepted whole-heartedly by all parties concerned. If not, you can't have it". Holland enjoyed this co-operation for a relatively long spell in peacetime. This was probably due to a combination of factors which would be inapplicable in most other industrialised countries. Therefore, the Dutch experience may be an unreliable guide to nations contemplating similar policies. In the United Kingdom the necessary spirit of co-operation was not present. The lack of resolution shown by the Labour Government in 1968, was itself an acknowledgement of the trade unions' suspicion and hostility to the incomes policy. Indeed, it remains uncertain whether the policy in Great Britain will have any enduring beneficial results. Perhaps, it may have even done more harm than good if it has made valuable changes within industry more difficult to carry through. Although exhortation may prove normally to be an ineffective method of controlling inflation, it may, on the other hand, be relatively harmless. Samuel Brittan(3) has asserted that "while few advanced Western countries operate statutory price and wage controls, hardly any have felt able to dispense with exhortations,

statements/....

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(2) J.PEN: "Harmony and Conflict in Modern Society" p. 72

(3) SAMUEL BRITTAN: "Steering the Economy" p. 324. It would perhaps, have been more accurate to have qualified the words "statutory..controls" with the word "extensive" or "pervasive". Minimum wage legislation for example, is not unusual. Nor is rent control.

statements of 'norms' and occasional arm-twisting. Incomes policies", he continues, "are thus a never ending series of tactical engagements with no victory or conclusion ever in sight". Moreover, he adds that "no one can say how much faster prices would have risen - or how much higher unemployment would have been required to contain inflation at a given rate - if governments had not bothered about the question at all".

We cannot confidently suggest a more precise conclusion to the study of incomes policies. We do not know the formula which will make an incomes policy both economically efficient and politically acceptable in industrialised Western countries.

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B I B L I O G R A P H Y

The bibliography contains all published work which has been referred to specifically in the thesis. Other work which has been helpful and relevant has been omitted as it would entail increasing the bibliography very considerably but would not direct the reader to any particular facts or contentions. The work listed below, however, contains many references to other useful material for anyone wishing to pursue further a particular issue. Perhaps, J.C.R. Dow's book "The Management of the British Economy, 1945-1960" (Cambridge University Press 1964) should, nevertheless, be mentioned, as it is of special interest in respect of the British post-war economy.

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